Supreme Court, U.S.
FILED
JUN 25 2009
OFFICE OF THE CLERK

No. 08-___ 09-2

IN THE

Supreme Court of the United States

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED, *et al.*,
Petitioners,

v.

TXU CORP., *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

FRANCIS J. BALINT JR.
BONNETT FAIRBOURN
FRIEDMAN & BALINT PC
2901 N. Central Avenue
Suite 1000
Phoenix, AZ 85012
(602) 274-1100

DAVID W. DODGE
DAVID W. DODGE PC
Regency Plaza
3710 Rawlins, Suite 1600
Dallas, TX 75219
(972) 523-3135

SAMUEL ISSACHAROFF
Counsel of Record
40 Washington Square South
New York, NY 10012
(212) 998-6580

ROSEMARY SHOCKMAN
SHOCKMAN LAW OFFICE PC
3001 E. Camelback, Suite 120
Phoenix, AZ 85016
(602) 955-2465

Counsel for Petitioners

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTIONS PRESENTED

1. Does Rule 9(b) hold allegations of intent to commit fraud, which otherwise may be alleged generally, to a higher standard of pleading when the alleged fraud is perpetrated by "corporations and their officers"?

2. Is it legal error under the Williams Act to dismiss a complaint that insiders knowingly failed to disclose an imminent increase in dividends in the context of a self-tender offer by corporate management on the basis of routine disclaimers that other circuits have termed "boilerplate waivers"?

RULE 14.1(B) STATEMENT

The Petitioners, who were plaintiffs and appellants below, are Flaherty & Crumrine Preferred Income Fund Incorporated; Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated; Flaherty & Crumrine/Claymore Preferred Securities Income Fund Incorporated; and Stan Haiduk. The combined Flaherty & Crumrine entities will be referred to hereinafter as F&C.

The Respondents, who were defendants and appellees below, are the TXU Corp. (which now is a privately help company operating under the name Energy Future Holdings Corp.) and its former President and CEO John Wilder.

RULE 29.6 STATEMENT

Petitioners F&C and Haiduk state that they have no parent corporation and that no publicly held corporation owns more than 10% of any issued stock.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
RULE 14(B) STATEMENT	ii
RULE 29.6 STATEMENT	ii
TABLE OF AUTHORITIES	vi
OPINIONS BELOW	1
JURISDICTION	2
STATUTORY PROVISIONS, RULES AND REGULATIONS INVOLVED	2
INTRODUCTION	3
STATEMENT	7
REASONS FOR GRANTING THE WRIT	15
I. THE FIFTH CIRCUIT HAS CREATED A SIGNIFICANT CONFLICT WITH OTHER CIRCUITS CONCERNING THE DISMISSAL OF COMMON LAW FRAUD AND STATUTORY SECURITIES FRAUD CLAIMS	15
A. The Creation of a Separate Standard for Business Fraud Under Rule 9(b) Contradicts the Holdings of the Court and Conflicts with the Law of Other Circuits	15
B. Crediting Pro Forma, General Disclaimers in the Face of Specific Misleading Statements Constitutes Impermissible Fact Finding at the Pleading Stage and Conflicts with the Law of Other Circuits on Boilerplate Disclaimers	21

TABLE OF CONTENTS—Continued

Page

II. THIS CASE PRESENTS A QUESTION OF NATIONAL IMPORTANCE CONCERNING THE INTEGRITY OF THE FINANCIAL MARKETS 26

III. THIS CASE PRESENTS AN EXCELLENT VEHICLE FOR CONSIDERING THE CENTRAL PLEADING QUESTIONS LEFT OPEN BY THE COURT'S RECENT DECISIONS 28

CONCLUSION 32

APPENDIX

APPENDIX A — April 8, 2009 Opinion of the Fifth Circuit Court of Appeals, *Flaherty & Crumrine Preferred Income Fund Inc. v. TXU Corp.*, No. 08-10414 ..... 1a

APPENDIX B — April 8, 2009 Judgment of the Fifth Circuit Court of Appeals, *Flaherty & Crumrine Preferred Income Fund Inc. v. TXU Corp.*, No. 08-10414 (issued as mandate on April 30, 2009) 25a

APPENDIX C — April 4, 2008 Memorandum Opinion and Order of the United States District Court for the Northern District of Texas, *Flaherty & Crumrine Preferred Income Fund Inc. v. TXU Corp.*, No. 3:05-CV-1784-G 27a

APPENDIX D — April 4, 2008 Judgment of the United States District Court for the Northern District of Texas, *Flaherty & Crumrine Preferred Income Fund Inc. v. TXU Corp.*, No. 3:05-CV-1784-G 49a

TABLE OF CONTENTS—Continued

Page

APPENDIX E — November 26, 2007 Plaintiffs' Second Amended Complaint 50a

APPENDIX F — November 26, 2007 Expert Report of Professor Linda Allen 108a

APPENDIX G — September 28, 2004 Presentation by C. John Wilder 169a

APPENDIX H — December 13, 2004 Letter from Philippe M. Salomon at Willkie, Farr & Gallagher, LLP to TXU 171a

APPENDIX I — January 18, 2005 Letter from David P. Poole at TXU to Philippe M. Salomon 178a

APPENDIX J — Timeline of Significant Factual Events 184a

APPENDIX K — May 18, 2004 Press Release 185a

TABLE OF AUTHORITIES

CASES Page

Acito v. IMCERA Group, Inc., 47 F.3d 47 (2d Cir. 1995) 18
Anderson v. Sara Lee Corp., 508 F.3d 181 (4th Cir. 2007) 19
Anderson, Greenwood & Co. v. Martin, 44 S.W.3d 200 (Tex. App. 2001) 16
Ashcroft v. Iqbal, 129 S.Ct. 1937 (2009) .....*passim*
Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007).....*passim*
DiLeo v. Ernst & Young, 901 F.2d 624 (7th Cir. 1990), *cert. denied*, 498 U.S. 941 (1990)..... 17
Dura Pharm., Inc. v. Broudo, 544 U.S. 336 (2005)..... 18
Edgar v. MITE Corp., 457 U.S. 624 (1982) . 8
Erickson v. Pardus, 551 U.S. 89 (2007)..... 26
Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) 17
Ernst & Young, L.L.P. v. Pac. Mut. Life Ins. Co., 51 S.W.3d 573 (Tex. 2001) 16
Fecht v. Price Co., 70 F.3d 1078 (9th Cir. 1995), *cert. denied*, 517 U.S. 1136 (1996). 22
Glenfed, Inc. Secs. Litig., 42 F.3d 1541 (9th Cir. 1994) (en banc)..... 17
Greenstone v. Cambex Corp., 975 F.2d 22 (1st Cir. 1992) 17
Halperin v. eBanker USA.com, Inc., 295 F.3d 352 (2d Cir. 2002)..... 21, 22
Hefferman v. Bass, 467 F.3d 596 (7th Cir. 2006)..... 19
Hoggett v. Brown, 971 S.W.2d 472 (Tex. App.1997) 16

TABLE OF AUTHORITIES—Continued

Page

In re Advanta Corp. Sec. Litig., 180 F.3d 525 (3d Cir. 1999) 18

In re Navarre Corp. Sec. Litig., 299 F.3d 735 (8th Cir. 2002) 20

Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit, 507 U.S. 163 (1993) 15, 21

Morganroth & Morganroth v. Norris, McLaughlin & Marcus, P.C., 331 F.3d 406 (3d Cir. 2003) 19

N. Am. Catholic Ed. Programming Found., Inc. v. Cardinale, No. 08-1403, 2009 WL 1382289, (1st Cir. May 19, 2009) 21

Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977) 28

Rondeau v. Mosinee Paper Corp., 422 U.S. 49 (1975) 28

Seattle-First Nat'l Bank v. Carlstedt, 800 F.2d 1008 (10th Cir. 1986) 17

Shaw v. Digital Equip. Corp., 82 F.3d 1194 (1st Cir. 1996) 22

Sonesta Int'l Hotels Corp. v. Wellington Assoc., 483 F.2d 247 (2d Cir. 1973) 8

Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 128 S.Ct. 761 (2008) 27

Swierkiewicz v. Sorema N.A., 534 U.S. 506 (2002) 15, 21

Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007) ..... *passim*

Trussell v. United Underwriters, Ltd., 228 F.Supp. 757 (D. Colo. 1964) 18

United States ex rel. SNAPP, Inc. v. Ford Motor Co., 532 F.3d 496 (6th Cir. 2008) ... 19

TABLE OF AUTHORITIES—Continued

Page

United States. ex rel. Willard v. Humana Health Plan of Tex. Inc., 336 F.3d 375 (5th Cir. 2003) 20
United States ex rel. Wilson v. Kellogg Brown & Root, Inc., 525 F.3d 370 (4th Cir. 2008) 20
West Coast Roofing and Waterproofing, Inc. v. Johns Manville, Inc., 287 Fed. Appx. 81 (11th Cir. 2008) 20
Wexner v. First Manhattan Co., 902 F.2d 169 (2d Cir. 1990) 17
Wight v. BankAmerica Corp., 219 F.3d 79 (2d Cir. 2000) 20

STATUTES & RULES

28 U.S.C. § 1254(1) 2
Fed. R. Civ. P. 9(b) ..... *passim*
Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b) (1-2) ..... *passim*
Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 3
Securities and Exchange Act of 1934, 15 U.S.C. § 78j 2
Williams Act, 15 U.S.C. § 78n(e) ..... *passim*

MISCELLANEOUS

Richard A. Epstein, Bell Atlantic v. Twombly: *How Motions to Dismiss Become (Disguised) Summary Judgments*, 25 Wash. U. J.L. & Pol'y 61, 82 (2007) 30, 31
S. Rep. No. 90-550 (1967) 28

IN THE

Supreme Court of the United States

No. 08-___

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED, *et al.*,
Petitioners,

v.

TXU CORP., *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The decision of record of the Fifth Circuit is reported as *Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, 565 F.3d 200 (5th Cir. 2009), reproduced at Pet. App. 1a[1] That decision affirmed *Flaherty & Crumrine Preferred Income Fund Inc. v. TXU Corp.*, No. 3:05-CV-1784-G, 2008 WL 918339 (N.D. Tex., April 4, 2008), reproduced at Pet. App. 27a.

The initial opinion of the district court was vacated and remanded by the Fifth Circuit in light of this

[1] All citations to the Appendix are designated "Pet. App. ___").

Court's ruling in *Tellabs, Inc., v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007). *See Flaherty & Crumrine Preferred Income Fund Inc. v. TXU Corp.*, 242 Fed. App'x 253 (5th Cir. 2007), *vacating and remanding Flaherty & Crumrine Preferred Income Fund v. TXU Corp.*, No. 3:05-CV-1784-G, 2006 WL 2583212, 2006 U.S. Dist. LEXIS 67264 (N.D.Tex. Aug. 30, 2006).

JURISDICTION

The judgment of the Court of Appeals was entered on April 8, 2009. The opinion appealed from was issued on April 8, 2009. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS, RULES AND REGULATIONS INVOLVED

There are three statutory provisions involved:

1. The Williams Act, 15 U.S.C. §78n(e), 82 Stat. 454, provides in relevant part that, "It shall be unlawful for any person ... to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer...."

2. Section 10b of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j, 48 Stat. 891, in relevant part provides that it shall be, "unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange ... [t]o use or employ, in connection with the purchase or sale of any security ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

3. Private Securities Litigation Reform Act of 1995 (hereinafter "PSLRA"), 15 U.S.C. §78u-4(b)(2), 109 Stat. 757, in relevant part requires that plaintiffs bringing a statutory securities fraud claim must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."

Also at issue is SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated pursuant to Section 10(b), which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Finally, Rule 9(b) of the Fed. R. Civ. P. provides:

> In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

INTRODUCTION

This case presents the critical issue of how to conduct proper fact-finding under the Court's recent pleading decisions. In the wake of *Bell Atlantic Corp.*

v. Twombly, 550 U.S. 544 (2007), and *Tellabs, Inc., v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007), lower courts have issued thousands of conflicting opinions regarding the proper inferences available to district courts in testing the sufficiency of the factual allegations in a complaint.

The issue appears in sharp relief in the instant case, which turns on a proposed "self-tender offer" by which the large utility company TXU in 2004 sought to reacquire its own mandatorily convertible securities. These convertible securities (referred to hereinafter as the "securities") were specialized financial instruments, largely held by sophisticated investors as a way to realize gains in TXU common stock, whose share price was in turn largely a function of TXU dividends. Both before and during the tender period TXU issued financial guidance to investors which indicated that there would be no increase in dividends before 2006. These specific representations were sometimes accompanied by generic disclaimers to the effect that management policy was "under review." Only six days after the expiration of its tender offer for the securities, to the surprise of those who had tendered their shares and to financial markets generally, TXU raised its dividends by 350 percent. Its shares accordingly shot up in value by 20 percent.

The district court held that the petitioners' Second Amended Complaint ("SAC") properly alleged all elements of a securities fraud claim save the requirement of scienter, and further ruled that an individual claim of common law fraud also failed to plead specifically the scienter element under Rule 9(b). The Fifth Circuit affirmed dismissal of the federal securities law claims, although it acknowledged that

the pleadings were sufficient to raise "a permissible inference of scienter." Pet. App. 20a. The Fifth Circuit instead credited TXU's routine disclaimers, which it deemed sufficient to refute any inference of scienter. Pet. App. 20a. The Fifth Circuit additionally affirmed dismissal of the individual common law fraud claim "[b]ecause Appellants failed to adequately allege fraudulent intent as required by Rule 9(b)." Pet. App. 24a.

This case raises two issues under different pleading standards. First, contrary to other circuits, the Fifth Circuit requires a different level of specificity in pleading state of mind for fraud under Rule 9(b) when the matter concerns fraud claims that may be "universal to corporations and their officers." Where business fraud is alleged, the Fifth Circuit requires "a plaintiff [to] set forth specific facts to support an inference of fraud." Pet. App. 22a. That requirement runs afoul of the Court's repeated rejection, most recently in *Ashcroft v. Iqbal*, 129 S.Ct. 1937 (2009), of higher pleading standards under the Federal Rules of Civil Procedure for particular substantive causes of action. Nothing in the case law nor in logic supports a requirement of specific factual allegations regarding the state of mind of another actor prior to any discovery.

Second, the Fifth Circuit's ruling runs afoul of the Court's repeated admonition that the determination of the adequacy of pleadings does not license a district court to weigh competing factual inferences as if it were sitting as a trier of fact. The question is rather whether a pleading offers a plausible account of the publicly available facts. This is the import of the Court's recent holdings under Rule 12(b)(6) in *Twombly*, as well as under the securities laws in

Tellabs. Most recently in *Iqbal*, the Court indicated that trial courts could appropriately require no greater detail in the complaint than was necessary to make allegations plausible. For trial courts to demand greater detail is tantamount to making first-order factual determinations at the motion to dismiss stage, and unjustifiably dismisses claims that warrant discovery.

Nonetheless, many courts, most notably the court below, have assumed a power to decide contested facts in a manner contrary to the dictates of this Court. Here, the Fifth Circuit upheld the dismissal of a securities fraud action despite the fact that the complaint provided a "permissible inference of scienter" that insiders deliberately failed to disclose an imminent increase in dividends that all parties concede was the pivotal determinant of the value of the securities in question. The courts below mistakenly read the Court's insistence on pleadings that are, in context, cogent and compelling as an invitation to resolve disputes of fact as if they were sitting as triers of fact at the trial on the merits.

As the Court has noted on many occasions, the proper functioning of the civil justice system depends on the delicate balance between removing frivolous cases at an early stage and preserving the availability of discovery and legal redress for well-founded claims. The recent pleading decisions have created wide uncertainty among the bar and lower courts. This case, presenting a unique allegation of direct fraud in the context of a company buy-back of its own securities, is an ideal vehicle to clarify the relationship between pleading standards and the limited authority of lower courts to engage in fact finding on a motion to dismiss.

STATEMENT OF THE CASE

This is not a garden variety case of alleged securities fraud. At issue is a "self-tender," in which a company offers to repurchase outstanding securities from its own investors for a fixed price. In the period between September 15 and October 13, 2004, TXU offered to buy back at a preset price an entire category of securities.[2] The plaintiffs below, and about two-thirds of the securities holders, tendered their shares at the offered price. Only six days after the close of the tender offer period, TXU announced a 350 percent increase in dividends – an increase whose planning was well underway but undisclosed during the tender offer – which immediately caused a dramatic increase in the value of the tendered securities. The question presented below was whether the plaintiffs in the SAC pled common law fraud with sufficient specificity under Fed. Rule Civ. P. 9(b) and whether there was a sufficient allegation of scienter under the PSLRA. The district court dismissed both the common law fraud and statutory securities fraud claims and the Fifth Circuit affirmed.

In assessing the sufficiency of the pleading, it is important to note that this case involves a tender offer, and specifically, a self-tender that is unique in at least three ways. First, rather than arising from an attempt to raise money on capital markets, a self-tender is an attempt by a cash-rich company to eliminate holders of its equities, often in anticipation of taking the company private – as indeed occurred with TXU in this case. The self-tender is an acute

---

[2] For ease of presentation, a complete timeline is included at Pet. App. 184a. This same exhibit was presented to the Fifth Circuit as a demonstrative exhibit at oral argument.

variation of the general problem in tender offers that the tender offeror has access to better information about the firm to be acquired than the investors.

Second, this fundamental informational asymmetry is the reason that there is a separate statutory provision for tender offers distinct from the general Securities Acts: the Williams Act, 15 U.S.C. §78n(e). In particular, Section 14(e) was enacted to protect investors in tender offers, founded on the principle that full and fair disclosure of all material facts must be made to the offerees so they can reach truly informed investment decisions. *Edgar v. MITE Corp.*, 457 U.S. 624, 633 (1982) ("There is no question that in imposing these [statutory] requirements, Congress intended to protect investors"). As the Second Circuit has noted:

> The obligation is placed squarely on those making the offer in the first instance to disclose all material factors necessary to make their offer not misleading. That duty cannot be shifted to the shoulders of others.

Sonesta Int'l Hotels Corp. v. Wellington Assoc., 483 F.2d 247, 249 (2d Cir. 1973).

Third, the Williams Act obligation of full disclosure is all the more compelling in the context of a self-tender, in which the temptation to distort or withhold material information can be overwhelming. A self-tender is an attempt to create demand from a targeted group of investors in the company's securities, rather than an attempt to create demand from the market at large. In a self-tender, only the buyer has inside information about the true value of the securities, as opposed to the customary concern under the Securities Acts about a seller potentially making

misrepresentations to the capital markets generally. Thus, in a self-tender offer, a corporation seeks to buy back its own securities from its investors based on an offer price established by the corporation itself – a corporation which, unlike the investors, is fully informed of information material to the true value of the securities being purchased. In this case, when TXU offered to buy from Petitioners and other similarly situated investors certain of TXU's convertible securities, the only possible source of information about the future prospects of the company was information obtained from TXU itself.

If ever there were a picture-perfect example of the concerns that underlie the Williams Act, it would be the present case. The securities at issue contained "mandatory conversion provisions," which obligated TXU to redeem them for TXU common stock at certain prescribed times. The value of the securities, which traded on a secondary market, was closely tied to the value of TXU common stock – a value which, like that of most utility stocks, was highly sensitive to the company's dividend rates. While the offeror – TXU's own management – was intimately familiar with pending plans to increase TXU's common-stock dividend, the steps taken in furtherance of that plan, and the timing of its recommendation to TXU's Board of Directors, the offerees were privy to none of these matters.

Petitioners' basic claim is that TXU misled the securities holders during the tender offer by withholding the critical fact that TXU planned to raise the dividend payments ***as soon as the tender offer expired.*** In the SAC, Petitioners set forth specific statements by TXU, repeated by President and CEO John Wilder during the tender offer period, that set

out specific performance objectives that would have to be met for dividends to be increased and further disclaimed any dividend increase for several years. Pet. App. 62a-70a, 170a. These statements affirmatively misrepresented the imminence of planned and dramatic increases in TXU's common stock dividend rate and common stock repurchase program, Pet. App. 72a, although these representations were accompanied by hollow disavowals that TXU did not know "when, if at all" TXU management would recommend such changes. Pet. App. 67a.

The SAC alleged that the object of these critical misrepresentations and omissions was to induce the investors to sell their securities back to TXU in the tender offer, rather than hold and redeem them later for TXU common stock at a much greater cost to TXU. Pet. App. 85a-86a. Petitioners also attached to the SAC an extensive expert report that detailed the steps necessary before a company such as TXU could undertake such a marked increase in its dividend payments – steps that could not have been taken within the few days between the expiration of the tender offer and the announcement of the dividend increase. Pet. App. 108a. The SAC then set forth additional facts showing that, contrary to the representations made to its investors during the tender offer, TXU was in fact feverishly preparing for the increases – including by consulting with a financial advisor and preparing detailed financial packages to deliver to its rating agencies – before the close of the tender offer. These preparations were timed to correspond to a Board of Directors meeting, scheduled well ahead of the close of the tender period to occur a few days after close of the tender offer period, where TXU management was slated to recommend an increase in the dividend payout. Pet. App. 71a-

74a. Even TXU's own in-house counsel had to admit the extensive activity that was occurring during the tender offer period. Pet. App. 180a-182a. TXU's own account of the events in question admits that the financial steps were completed one day before the expiration of the tender offer and that management affirmatively decided not to inform the securities holders of any of the underlying activity. Pet. App. 181a.

All of these facts were pleaded in great detail in the SAC. Pet. App. 50a-53a, 58a-59a, 65a-77a. Further, they are captured in the Fifth Circuit's account of the critical facts of the case:

> Prior to the tender offer, Wilder, TXU's CEO, had implemented a three-phase restructuring program aimed at improving TXU's business. On May 18, 2004, approximately four months before the tender offer, TXU issued a press release outlining its view of the company's financial restructuring program. The press release indicated that TXU did not anticipate a dividend increase until 2006, when certain financial benchmarks were reached, but noted that TXU's Board of Directors (the "Board") might consider other relevant factors in determining when or if to authorize a dividend increase . . . .
>
> On September 15, 2004, TXU announced [the tender offer.] . . . TXU also announced its intent to repurchase up to 10 million shares of its common stock, subject to market conditions and other factors. On September 28, 2004, CEO Wilder made a presentation in which he reiterated previous representations that the dividend policy was under review and discussed TXU's capital allocation and growth strategy.

> On October 12, 2004, just one day before the expiration of the offer, TXU management gave a detailed financial plan to certain credit rating agencies for the purpose of facilitating the agencies' determinations of whether an increase in TXU's annual dividend would adversely affect the corporation's credit rating. . . . On October 19, 2004, six days after the end of the tender offer period, TXU management provided materials to the Board proposing a change in dividend policy, and on October 21, 2004, management recommended a 350% increase of the annual dividend on common stock and a 400% increase in the stock repurchase program. In the interim between management's provision of the materials to the Board and the final recommendation, TXU management received final reports from the credit rating agencies informing the corporation that an increase in dividend payouts would not adversely affect its credit rating. On October 22, 2004, the Board approved the dividend increase and the stock repurchase program. On October 25, 2004, TXU publicly announced its plan to increase the common stock dividend from $0.50 to $2.25 and to repurchase approximately 50 million shares of TXU common stock. Immediately following the announcement, the per-share value of TXU common stock jumped nearly 20%.

Pet. App. 2a-5a.

After the dividend announcement, Petitioner F&C immediately retained counsel, complained about the specific misrepresentations during the heart of the tender offer period, and demanded an explanation. Pet. App. 80a, 171a-177a. In response, TXU in a

letter from counsel admitted that its management had been working on the dividend increases during the tender offer, had prepared a Board meeting to ratify those increases, but had not informed the investing public of any of these developments. Pet. App. 181a-82a. Further, TXU admitted that the predictable effect of increases in dividends for a public utility stock would be a spike in stock value. Pet App. 178a. Nonetheless, in the letter from Associate General Counsel David Poole, TXU for the first time claimed that the increases hinged upon its receipt of word from the rating agencies that the planned increases would not adversely affect TXU's financial ratings – word which TXU contended arrived only *after* the tender offer closed. Pet. App. 181a-82a. Poole's letter is the only support in the record or in any public account for the claim that TXU was passively awaiting approval from the rating agencies.

As specifically alleged in the SAC, and as corroborated in the expert report of Professor Linda Allen incorporated into the SAC, this contention is not only unsubstantiated, Poole's explanation is not even plausible in light of industry practices. Professor Allen describes in considerable detail how a sophisticated company like TXU prepares for such a large increase in dividends and the type of constant communication and feedback on this subject with its rating agencies that would have occurred throughout the tender offer. Pet. App. 136a-37a.

The fundamental scienter issue presented, then, is whether TXU and its management knew of facts that rendered false and misleading their representations and omissions made during the tender offer regarding the imminence of the stock dividend and repur-

chase increases. The Fifth Circuit chose ultimately to credit TXU's account of the facts, largely from the Poole letter, over the facts pleaded in the SAC:

> Although the Allen Report provides some support for the notion that TXU's management likely made preparations for the dividend increase before the close of the tender offer, such preparations do not support a cogent and compelling inference that Wilder or other TXU management were intentionally or recklessly misleading investors. In fact, the statement that the dividend policy was "under review" conveyed that TXU had taken some steps in evaluating a change in the dividend policy.

Pet. App. 17a.

The specific allegations in the SAC are to the contrary. Whether the vague and routine "under review" disclaimer is sufficient to put on notice sophisticated investors who follow the detailed financial benchmarks of the firm is a matter of fact. There is no authority for a court to resolve contested factual issues at the motion to dismiss stage. That is the issue before the Court on this petition.

REASONS FOR GRANTING THE WRIT

I. THE FIFTH CIRCUIT HAS CREATED A SIGNIFICANT CONFLICT WITH OTHER CIRCUITS CONCERNING THE DISMISSAL OF COMMON LAW FRAUD AND STATUTORY SECURITIES FRAUD CLAIMS.

A. The Creation of a Separate Standard for Business Fraud Under Rule 9(b) Contradicts the Holdings of the Court and Conflicts with the Law of Other Circuits.

Three times in recent years, the Court has had to instruct lower courts that, absent amendment, the Federal Rules of Civil Procedure apply to all actions in the federal courts – and that courts are not free to pick and choose how to apply the federal rules depending on the underlying substantive law. *See Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1953 (2009) (rejecting interpretations of *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007), that would have limited its application to the antitrust context); *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 511 (2002) (rejecting special pleading rules for age discrimination claim and reasserting that "the ordinary rules for assessing the sufficiency of a complaint apply"); *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993) (rejecting specific heightened pleading standard for municipal liability claims, and reversing the Fifth Circuit's subject-matter specific pleading standard).

In the present case, the named plaintiffs directly alleged fraud under Texas common law. This is not a statutory claim of fraud, and is not grounded in the

fraud on the market or any application of the efficient market hypothesis. As set out clearly in F&C's letter to TXU, issued immediately after the disclosure of the dividend increase, the simple claim was one of fraudulent deceit as a result of the reiteration of TXU's supposedly controlling financial benchmarks in the September 28, 2004 presentation by CEO John Wilder. Pet. App. 171a. This claim of common law fraud is not governed by the PSLRA, 15 U.S.C. § 78u-4(b)(1-2).

Under controlling Texas law, the elements of a common law fraud claim are: (1) a material representation; (2) that is false; (3) made with knowledge of its falsity or recklessness as to its truth; (4) made with the intention that it be acted upon by another party; (5) relied upon by the other party; and (6) causing injury. *Ernst & Young, L.L.P. v. Pac. Mut. Life Ins. Co.*, 51 S.W.3d 573, 577 (Tex. 2001). Further, under Texas law, one who undertakes to speak must do so truthfully. *Hoggett v. Brown*, 971 S.W.2d 472, 487 (Tex. App. 1997) ("when one voluntarily discloses information, the whole truth must be disclosed"); *Anderson, Greenwood & Co. v. Martin*, 44 S.W.3d 200, 212-13 (Tex. App. 2001) ("when one makes a representation, he has a duty to disclose new information when he is aware the new information makes the earlier representation misleading or untrue").

When brought in federal court, such common law fraud claims must satisfy the pleading standards of Rule 9(b), which requires a party to "state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally." Rule 9(b), Fed. R. Civ. P. Under the express lan-

guage of the Rule, there is a sharp distinction between the particularity requirement for the factual elements of the fraud, and the general pleading requirements of the state of mind of the alleged perpetrator of the fraud. This is by contrast to the PSLRA, which "requires plaintiffs to state with particularity ... the facts evidencing scienter, i.e., the defendant's intention to 'deceive, manipulate, or defraud.'" *Tellabs, Inc. v. Makor Issues & Rights. Ltd.*, 551 U.S. 308, 127 S.Ct. 2499, 2504 (2007) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 & n. 12 (1976)).

Prior to the passage of the PSLRA, the circuits were divided on the issue of whether securities fraud required a heightened pleading standard, beyond that which applies under ordinary fraud cases.[3]

---

[3] *Contrast Greenstone v. Cambex Corp.*, 975 F.2d 22, 25 (1st Cir. 1992) (holding "inadequate a complaint's general averment of the defendant's 'knowledge' of material falsity, unless the complaint also sets forth specific facts that make it reasonable to believe that defendant knew that a statement was materially false or misleading."); *Wexner v. First Manhattan Co.*, 902 F.2d 169, 172 (2d Cir. 1990) ("Although scienter need not be alleged with great specificity, plaintiffs are still required to plead the factual basis which gives rise to a 'strong inference' of fraudulent intent.") (citations omitted); *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990), *cert. denied*, 498 U.S. 941 (1990) ("[T]he complaint ... must afford a basis for believing that plaintiffs could prove scienter."); *with Glenfed, Inc. Secs. Litig.*, 42 F.3d 1541, 1545 (9th Cir. 1994) (en banc) ("Our first task is to determine whether we should adopt the Second Circuit's view that plaintiffs in securities fraud cases must plead facts giving rise to a "strong inference of fraudulent intent. We conclude that we should not."); *Seattle-First Nat'l Bank v. Carlstedt*, 800 F.2d 1008, 1011 (10th Cir. 1986) ("Rule 9(b) does not ... require the pleading of detailed evidentiary matter, nor does it require any particularity in connection with an averment of intent,

Tellabs, 127 S.Ct at 2507. That division reflected the distinct manner in which the fraud on the market theory in efficient markets relieves plaintiffs of the customary burden of proving the direct reliance element of a fraud claim. The conflict between the circuits was resolved statutorily by the passage of the PSLRA, which imposed a heightened requirement for pleading the scienter element of a statutory securities fraud claim: "The [PSLRA] insists that securities fraud complaints 'specify' each misleading statement; that they set forth the facts 'on which [a] belief that a statement is misleading was 'formed'; and that they 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'" *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 345 (2005) (quoting the PSLRA). Indeed, most courts have held that the PSLRA in effect adopts the pre-PSLRA standard articulated by the Second Circuit that plaintiffs must allege facts giving rise to "a strong inference of fraudulent intent." *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534-35 (3d Cir. 1999) (quoting *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 52 (2d Cir.1995)).

With the PSLRA, Congress statutorily resolved the specificity required to plead fraud on the market. But the Fifth Circuit has taken the former division in authority as an invitation to reject the express commands of Rule 9(b) for fraud claims not brought under the PSLRA. In place of the straightforward language of Rule 9(b), the Fifth Circuit crafted its own rule "that certain motives alleged, especially those universal to corporations and their officers, do not suffice to establish an inference of fraud under

---

knowledge, or condition of mind." quoting *Trussell v. United Underwriters, Ltd.*, 228 F. Supp. 757, 774-75 (D. Colo. 1964)).

Rule 9(b)." Pet. App. 22a-23a. Thus, "the motive attributed to Appellees by Appellants – the desire to complete a financially successful tender offer – is insufficient to establish an inference of fraud under Rule (9)(b)." Pet. App. 23a. The lack of specific fact pleading as to defendants' state of mind is then the basis for the Fifth Circuit's holding: "Because Appellants failed to adequately allege fraudulent intent as required by Rule 9(b), the district court did not err in dismissing the claim for common law fraud." Pet. App. 24a.

Not only is the Fifth Circuit pleading requirement for common law claims contrary to the express requirement of Rule 9(b), but it highlights a conflict in the circuits on this critical pleading issue. Most circuits reject any departure from the express command of Rule 9(b) for claims of fraud regardless of the subject matter of the lawsuit. *See United States ex rel. SNAPP, Inc. v. Ford Motor Co.*, 532 F.3d 496, 505 (6th Cir. 2008) (question whether defendant acted with requisite "state of mind may only be pled generally"); *Anderson v. Sara Lee Corp.*, 508 F.3d 181, 188-89 (4th Cir. 2007) (vacating 12(b)(6) dismissal of North Carolina common law fraud claim based on district court's conclusion plaintiffs failed to allege intent to deceive); *Hefferman v. Bass*, 467 F.3d 596, 601-02 (7th Cir. 2006) (overturning dismissal of fraud claim even though "'nothing in the allegations even suggests that Bass knew (as opposed to should have known) . . .'" that he was joining a fraudulent scheme; that relates to defendant's "'knowledge' or 'condition of mind,' which as noted above Rule 9(b) permits to be alleged generally"); *Morganroth & Morganroth v. Norris, McLaughlin & Marcus, P.C.*, 331 F.3d 406, 413-14 (3d Cir. 2003) (reversing 12(b)(6) dismissal of fraudulent transfer claim based on district court's

finding of failure to allege facts supporting required state of mind); *In re Navarre Corp. Sec. Litig.*, 299 F.3d 735, 742 (8th Cir. 2002) ("the PSLRA supersedes reliance on 9(b) in securities fraud cases. . . . Specifically, the PSLRA requires that both falsity and scienter be pleaded with particularity. Under 9(b), "[m]alice, intent, knowledge, and other condition of mind of a person [could] be averred generally." Fed. R. Civ. P. 9(b)"); *Wight v. BankAmerica Corp.*, 219 F.3d 79, 91 (2d Cir. 2000) ("while the 'actual ... fraud alleged must be stated with particularity ... the requisite intent of the alleged [perpetrator of the fraud] need not be alleged with great specificity.' We apply the more general standard to scienter for the simple reason that 'a plaintiff realistically cannot be expected to plead a defendant's actual state of mind.'" (internal citations omitted)). Although in unpublished opinions, the Eleventh Circuit follows the same approach. *See, e.g., West Coast Roofing & Waterproofing, Inc. v. Johns Manville, Inc.*, 287 Fed. Appx. 81, 88 (11th Cir. 2008) ("While plaintiff provides only conclusory allegations that defendant made those statements knowing they were false – less culpable explanations are certainly possible – Rule 9(b) permits states of mind, including knowledge, to be plead generally").

In addition to the Fifth Circuit in the present case, there are some circuits that selectively apply heightened pleading requirements to some causes of action. Thus, the Fourth Circuit, following the Fifth Circuit in *United States ex rel. Willard v. Humana Health Plan of Tex. Inc.*, 336 F.3d 375, (5th Cir. 2003), requires heightened fact pleading for the state of mind in statutory False Claims Act cases. *See United States ex rel. Wilson v. Kellogg Brown & Root, Inc.*, 525 F.3d 370, 379-80 (4th Cir. 2008). Further,

the First Circuit, relying on pre-PSLRA statutory securities case law, recently dismissed a common law fraud claim for failure to plead scienter with factual particularity. *N. Am. Catholic Ed. Programming Found., Inc. v. Cardinale*, No. 08-1403, 2009 WL 1382289, (1st Cir. May 19, 2009) (applying heightened 9(b) pleading standard to common law fraud claims).

These holdings of the Fifth, Fourth and First Circuits are contrary to the express language of Rule 9(b) and contrary to the requirement of transsubstantive application of the Rules of Civil Procedure, as set forth in *Iqbal, Swierkiewicz*, and *Leatherman*. The Court should grant review to resolve the split in the Circuits and to restore the proper application of Rule 9(b).

B. Crediting Pro Forma, General Disclaimers in the Face of Specific Misleading Statements Constitutes Impermissible Fact Finding at the Pleading Stage and Conflicts with the Law of Other Circuits on Boilerplate Disclaimers.

The Second Circuit – the court with by far the greatest experience in securities cases – has recognized that, "[c]autionary language in securities offerings is just about universal. Thus, the key question a district court must decide when determining whether to grant a motion to dismiss a securities fraud complaint is whether plaintiffs have overcome the existence of such language." *Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 359 (2d Cir. 2002). While recognizing that what constitutes fraud will depend on context, the Second Circuit elaborated the leading test for assessing the role of boilerplate dis-

claimers: "a complaint fails to state a claim of securities fraud if *no reasonable investor* could have been misled about the nature of the risk when he invested." *Id.* (emphasis in original). Other courts have articulated a similar test in noting the limitations of the "bespeaks caution" doctrine concerning generalized disclaimers. *See Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9th Cir. 1995), *cert. denied*, 517 U.S. 1136 (1996) (dismissal as matter of law is appropriate "only when reasonable minds could not disagree as to whether the *mix* of information in the [allegedly actionable] document is misleading" (emphasis in original)). For example, the First Circuit requires that a misrepresentation may be overcome only by an "unambiguous warning" about a possible reversal of course in the conduct being contemplated. *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1214 (1st Cir. 1996).

In the present case, by contrast, the Fifth Circuit decided that it could resolve the contested factual inferences in favor of TXU's unspecific disclaimers. The SAC sets out with specificity the repeated presentations made by TXU to investors detailing financial projections as the predicate for dividend increases, even if on occasion these projections were coupled with generic statements of the possibility of further management review. From the very outset of his tenure with TXU, Wilder emphasized satisfaction of specific financial benchmarks as conditions precedent to management's recommendation of a dividend increase. For example, in his very first analyst call in February 2007, Wilder stated:

> [F]rom my standpoint as management, I wouldn't be comfortable making a material change in the dividend policy, until I knew all of our businesses

> were running at high performance levels and I knew we had more than adequate financial flexibility to withstand any market shocks that the company might have. In my way of thinking and with the business portfolio we have our debt would be net debt to total capital in the 40-45 range and strong coverage ratios of 4.0 or greater, I think we can achieve that by '06 and quite frankly there is a possibility we can achieve that by '05.

Pet. App. at 61a. Subsequently, in announcing the critical economic restructuring in May 2004, TXU issued a series of specific economic benchmarks that would guide financial decisions, again including a specific prediction that there would be no increase in dividend payments before 2006. Pet. App. 2a-3a, 63a-64a, 195a-196a. That statement included a generic disclaimer that "the Board of Directors may consider other relevant factors in determining if and when to make a change in the dividend policy." Pet. App. 4a.

On September 28, 2004, in the heart of the tender offer period, CEO Wilder repeated the same financial benchmarks for dividend increases at an investors' conference, complete with the targets that would need to be met prior to any increase in dividends. Again, the specific financial benchmarks were accompanied by a generic statement that TXU's dividend policy was "under review." Pet. App. 13a. Meanwhile, TXU was taking affirmative steps to increase radically its historic dividends, including preparation of a written recommendation to be presented at a Board meeting previously scheduled for that purpose, and submitting dividend increase proposals to its rating agencies, all without reference to the benchmarks or any notice to the tender

offerees beyond the generic statement that matters were "under review." Pet. App. 4a-5a.

As events played out, the unprecedented jump in dividend payments occurred just six days after the tender period expired, something even the Fifth Circuit had to acknowledge was "suspect." Pet. App. 15a. Contrary to all other circuits, the Fifth Circuit at the motion to dismiss stage upheld a factual determination that a boilerplate disclaimer defeated specific representations to the contrary: "the statement that the dividend policy was 'under review' conveyed that TXU had taken some steps in evaluating a change in the dividend policy." Pet. App. 17a.

This assumption of the power to weigh facts at the pleading stage is contrary to the Court's holding in *Tellabs*:

> We emphasize, as well, that under our construction of the "strong inference" standard, a plaintiff is not forced to plead more than she would be required to prove at trial. A plaintiff alleging fraud in a § 10(b) action, we hold today, must plead facts rendering an inference of scienter *at least as likely as* any plausible opposing inference. At trial, she must then prove her case by a "preponderance of the evidence."

127 S.Ct. at 2513 (emphasis in original). To be sure, it is uncertain under *Tellabs, Twombly* and *Iqbal* how such a comparison of factual inferences is to be undertaken. *Tellabs* states:

> To determine whether the plaintiff has alleged facts that give rise to the requisite "strong inference" of scienter, a court must consider plausible nonculpable explanations for the defendant's conduct, as well as inferences favoring the

> plaintiff. . . . A complaint will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least *as compelling as any opposing inference one could draw from the facts alleged.*

127 S.Ct. at 2510 (emphasis added). The clear implication is that the factual universe to be weighed is defined by facts that are alleged in a non-conclusory fashion. But here, the Fifth Circuit assumed the role of fact finder:

> TXU could not have disclosed that a dividend increase was likely during the tender offer without running a risk of liability if the dividend increase was not ultimately approved. . . . The statement that the dividend policy was "under review" appears to be a statement that, although vague, accurately represents the state of the dividend policy during the tender offer period.

Pet. App. 18a. In this brief passage, the Fifth Circuit accepts as factually true (a) that TXU's motivation for nondisclosure was the risk of potential liability; (b) that the dividend increase was contingent on approval by outside agencies; and (c) that an admittedly "vague" statement regarding dividend policy constitutes both an accurate statement of policy and an accurate statement of motivation, even though a dividend increase was in fact already being planned. Implicitly, and to the contrary of other circuits, the Fifth Circuit also finds that a reasonable investor could not have been misled by the resulting mix of statements, despite finding that the combined allegations "provide a basis for some inference of fraud . . ." Pet. App. 20a.

Each of these factual conclusions is contrary to specific facts pleaded in the SAC, which were in turn

supported by an expert report. Each of these conclusions resolves contested facts in favor of a self-serving statement issued after-the-fact by TXU's in-house counsel. This impermissible fact finding is stated even more bluntly by the district court: "[t]he plaintiffs ignored the writing on the wall." Pet. App. 41a. The district court thus felt no constraint in rejecting the specific factual allegations of the SAC and crediting the rendition of facts raised only by TXU's counsel: "[t]he mere fact that a board meeting had been scheduled to discuss the dividend policy did not make the increase 'imminent' - TXU still needed to obtain information from the credit agencies, and the board still needed to consider that information and make a decision." *Id.*

Such intricate fact finding strays far beyond the assessments of plausibility the Court has allowed on a motion to dismiss. As the Court reiterated only two years ago, "when ruling on a defendant's motion to dismiss, a judge must accept as true all of the factual allegations contained in the complaint." *Erickson v. Pardus*, 551 U.S. 89, 127 S.Ct. 2197, 2200 (2007). The Court should grant review to clarify how the plausibility review set out in *Twombly* and *Tellabs* is to be carried out consistent with the longstanding and fundamental injunction that the factual allegations of a complaint must be taken as true at the motion to dismiss stage.

II. THIS CASE PRESENTS A QUESTION OF NATIONAL IMPORTANCE CONCERNING THE INTEGRITY OF THE FINANCIAL MARKETS.

The Court has emphasized on many occasions that the integrity of the national securities markets depends of the effective administration of laws that

combat fraud. *See, e.g., Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S.Ct. 761, 770 (2008) (stressing that a "dynamic, free economy presupposes a high degree of integrity . . . that must be enforceable by rules enforceable in fair, independent, accessible courts"). It is almost trite to observe the potentially catastrophic vulnerability of the securities markets to fraudulent misrepresentation and insider manipulation of the critical information upon which well-functioning markets rely.

Bluntly put, the opinions below create a standard that effectively precludes legal recourse for fraud. First, imposing a heightened standard for pleading common law fraud when it involves alleged corporate financial misconduct is not only contrary to the Federal Rules of Civil Procedure, but is hostile to the public interest in preserving the integrity of the capital markets. The barrier to recourse for fraud is heightened by sanctioning the use of Rule 12(b)(6) to dismiss even plausible accounts of fraud where specific and false representations are accompanied by a generic disclaimer that all matters are subject to review.

It is in the nature of the modern business enterprise that all company decisions are in some sense subject to "review." To permit firms to immunize themselves from accountability – indeed, even from discovery – for specific misrepresentations by tossing in such anodyne boilerplate language is to license gross market manipulation. A motion to dismiss cannot possibly resolve as a matter of law whether generalized statements that management intended to review dividend payments, coupled with presentation of specific, objective (but unsatisfied) financial benchmarks as conditions precedent to any dividend in-

crease, were sufficient to alert investors to the imminence of a well-matured plan for an unprecedented 350 percent hike in dividends as soon as the tender offer expired.

Summary resolution of disputed facts is particularly inappropriate under the Williams Act. There, Congress was attuned to the particular vulnerability of shareholders in the pressurized context of a tender offer – a concern only compounded in the context of a self-tender. The purpose of the Williams Act was "to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information regarding the qualifications and intentions of the offering party." *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975). *See also Piper v. Chris-Craft Indus., Inc.*, 430 US 1, 30 (1977) (a basic purpose of the Williams Act is "plac[ing] investors on an equal footing with the takeover bidder") (quoting S. Rep. No. 90-550, at 4 (1967)).

The concern over the integrity of American financial markets applies not only to enterprises being taken public, but to those that are being taken private through tender offers. This is the historic significance of the Williams Act and the Court should grant review to enforce the important statutory policies at issue.

III. THIS CASE PRESENTS AN EXCELLENT VEHICLE FOR CONSIDERING THE CENTRAL PLEADING QUESTIONS LEFT OPEN BY THE COURT'S RECENT DECISIONS.

To date, the Court's major new pleading decisions have addressed two situations: first, where the plain-

tiff's allegations do no more than repeat the elements of the substantive law; and, second, where the plaintiff's claims rely on publicly available information that is countered by a more plausible account of the public facts of record. It is the lack of any factual basis for the claims outside the public domain that unifies the major pleading cases, and that provides the legal basis for a motion to dismiss without factual discovery.

The Fifth Circuit in the present case, however, goes beyond what the Court has permitted, and beyond what should be permitted, at the pleading stage. The Fifth Circuit dismissed the underlying action based on what can only be described as fact finding. The Fifth Circuit weighed the specific allegations in the SAC, supported by an expert report on the elaborate process by which a large utility would have increased its dividends, against untested, unsupported, and self-serving factual representations made after-the-fact by TXU's lawyer.

This cannot be squared with "the tenet that a court must accept as true all of the allegations contained in a complaint . . ." *Iqbal*, 129 S.Ct. at 1949; *see also Tellabs*, 127 S.Ct. at 2509 (on a motion to dismiss, courts must "accept all factual allegations in the complaint as true"). Nor can it be reconciled with the Court's insistence through all the pleading cases that legal conclusions do not substitute for facts. *See Iqbal*, 129 S.Ct. at 1949 (emphasizing that under *Twombly*, "threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice").

Iqbal draws the critical distinction between specific pleaded facts which must be taken as true and the general conclusions that follow, which are subject to

the plausibility standard. In analyzing *Twombly*, the Court explained, "[b]ecause the well-pleaded fact of parallel conduct, accepted as true, did not plausibly suggest an unlawful agreement, the Court held the plaintiffs' complaint must be dismissed." 129 S.Ct. at 1950. The Court is careful here not to license lower courts to find facts on a motion to dismiss, but only to weigh the legal significance of the facts properly alleged. This is directly contrary to what the Fifth Circuit did below in crediting one set of unverified facts proffered by the defendant (i.e., the need to await the decisions of the rating agencies) over the factual averment in the complaint (i.e., preparations for a massive dividend increase were underway during the tender offer period and were not disclosed to the offerees).

Twombly, *Tellabs*, and *Iqbal* all emphasize that assessing the facts properly asserted in a complaint is "a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." *Iqbal*, 129 S.Ct. at 1950. Neither judicial experience nor common sense are the basis for crediting privately asserted, non-public facts propounded by the defendant's counsel over the factual allegations in the complaint. This point is well developed by Professor Richard Epstein, writing in staunch defense of the Court's ruling in *Twombly*. Characterizing the Court's ruling as a "mini-summary judgment," Professor Epstein argues that a motion to dismiss should be

> [. . .] available solely when the plaintiff relies on public information and its ostensible economic implications. In these circumstances the defendant cannot defeat the claim for summary judgment prior to discovery if that defense relies

> on private information that should be vetted through discovery. But so long as it relies on what we may term evidence of "like kind" with what the plaintiff presents, the motion to dismiss, in line with the undercurrent in the earlier precedents, should be squared with the emerging case law in both antitrust law and beyond.

Richard A. Epstein, Bell Atlantic v. Twombly*: How Motions to Dismiss Become (Disguised) Summary Judgments*, 25 Wash. U. J.L. & Pol'y 61, 82 (2007). Where the complaint and the motion to dismiss turn on a similar universe of facts available in the public domain, a motion to dismiss may properly lie because "exhaustive discovery will not advance the substantive inquiry into illegal practices." *Id.*

The Court has never upheld a motion to dismiss based upon an unverifiable, self-serving account of what a defendant was thinking. Reliance on non-public reasons for acting should be a per se barrier to a motion to dismiss. Such assertions must be subjected to discovery, particularly when they are introduced to defeat a factually specific complaint that provides a permissible inference of scienter. This scenario falls beyond the outposts staked out by the Court's recent pleading jurisprudence.

This case provides a clear factual record upon which to clarify the relation between permissible inferences on a motion to dismiss and the impermissibility of fact finding before discovery.

CONCLUSION

For the foregoing reasons, the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

FRANCIS J. BALINT JR.
BONNETT FAIRBOURN
FRIEDMAN & BALINT PC
2901 N. Central Avenue
Suite 1000
Phoenix, AZ 85012
(602) 274-1100

DAVID W. DODGE
DAVID W. DODGE PC
Regency Plaza
3710 Rawlins, Suite 1600
Dallas, TX 75219
(972) 523-3135

SAMUEL ISSACHAROFF
Counsel of Record
40 Washington Square South
New York, NY 10012
(212) 998-6580

ROSEMARY SHOCKMAN
SHOCKMAN LAW OFFICE PC
3001 E. Camelback, Suite 120
Phoenix, AZ 85016
(602) 955-2465

Counsel for Petitioners

June 25, 2009

APPENDIX

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

[Filed April 8, 2009]

No. 08-10414

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED; FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND INCORPORATED; FLAHERTY & CRUMRINE/CLAYMORE PREFERRED SECURITIES INCOME FUND INCORPORATED; STAN HAIDUK,

Plaintiffs-Appellants,

v.

TXU CORP.; C. JOHN WILDER,

Defendants-Appellees.

Appeal from the United States District Court
for the Northern District of Texas

Before KING, BENAVIDES, and CLEMENT, *Circuit Judges.*

FORTUNATO P. BENAVIDES, *Circuit Judge*:

Appellants, Flaherty & Crumrine Preferred Income Fund, Inc.; Flaherty & Crumrine Preferred Income Opportunity Fund, Inc.; Flaherty & Crumrine/Claymore Preferred Securities Income Fund, Inc. (collectively, "F&C"); and Stan Haiduk ("Haiduk"), filed a securities fraud class action and individual

fraud claims against Appellees TXU Corporation ("TXU") and its former CEO John Wilder ("Wilder") for allegedly making material misrepresentations and omissions of fact in connection with a self-tender offer to purchase certain convertible TXU securities (the "tender offer") in 2004. Specifically, Appellants alleged that Appellees fraudulently misrepresented the timing and magnitude of a planned stock repurchase program and dividend increase in order to induce the Appellants to participate in the tender offer. The district court dismissed Appellants' fraud claims alleged under Sections 10(b) and 14(e) of the Securities Exchange Act and SEC Rule 10b-5, as well as Appellants' common law fraud claims, for failure to state a claim under the heightened pleading standards applicable to securities fraud claims. We affirm the judgment of the district court.

I.

Appellants are three investment funds (F&C) and an individual plaintiff (Haiduk), all of whom owned convertible TXU securities called TXU Corporate Units (the "Corporate Units") and TXU Income PRIDES (the "PRIDES"). Both classes of securities were traded on the New York Stock Exchange and were convertible into TXU common stock.

Prior to the tender offer, Wilder, TXU's CEO, had implemented a three-phase restructuring program aimed at improving TXU's business. On May 18, 2004, approximately four months before the tender offer, TXU issued a press release outlining its view of the company's financial restructuring program. The press release indicated that TXU did not anticipate a dividend increase until 2006, when certain financial benchmarks were reached, but noted that TXU's Board of Directors (the "Board") might consider other

relevant factors in determining when or if to authorize a dividend increase:

> Upon reaching the targeted balance sheet strength and financial flexibility, management would recommend that the Board of Directors reevaluate the current dividend policy. At that time, management expects it would recommend targeting annual common stock dividends equal to a pay out of 100 percent of the earnings of TXU's electric delivery business. Of the free cash flow, management would expect to return roughly 80 percent to shareholders in the form of distributions or repurchases and to retain roughly 20 percent for long term growth initiatives. Assuming the execution of the business initiatives and transactions described above, and depending on market trends in commodity prices, management expects that this capital allocation program will enable management to recommend an increase of the dividend in 2006. In addition to management's recommendation, the Board of Directors may consider other relevant factors in determining if and when to make a change in the dividend policy.

On September 15, 2004, TXU announced that it was offering to purchase up to 11,433,285 outstanding Corporate Units and up to 8,700,000 outstanding PRIDES. Appellants collectively held 530,000 Corporate Units and 5,000 PRIDES prior to the tender offer. Investors holding the outstanding securities had the option to tender their securities to TXU or retain them, and Appellants were among the roughly 65% of investors who accepted the tender offer and sold their securities back to TXU. The price offered for the securities in the tender offer was $52.28 for each Cor-

porate Unit and $52.39 for each PRIDE. The tender offer purchase price was determined by applying a factor to the twenty-day weighted average price of TXU common stock between September 20, 2004, and October 8, 2004. The tender price was higher than the market price for the securities at the time of the tender offer. The offer itself (as well as forms filed with the SEC and the associated press release) contained the following language concerning the dividend policy:

> TXU Corp.'s debt and capital management program is intended to strengthen TXU Corp.'s balance sheet and financial flexibility. As a part of its capital management and restructuring program and considering current business and market conditions, TXU Corp.'s management is evaluating whether it should recommend to the TXU Corp. Board of Directors that they reevaluate TXU Corp.'s current common stock dividend policy. TXU Corp. cannot predict the outcome of management's evaluation, when, if at all, management would make a recommendation to the Board of Directors to change the current common stock dividend policy, or what management's recommendation might be. In addition to any recommendation from management, the Board of Directors may consider other relevant factors in determining if and when to make a change in TXU Corp.'s common stock dividend policy.

TXU also announced its intent to repurchase up to 10 million shares of its common stock, subject to market conditions and other factors. On September 28, 2004, CEO Wilder made a presentation in which he reiterated previous representations that the divi-

dend policy was under review and discussed TXU's capital allocation and growth strategy.

On October 12, 2004, just one day before the expiration of the offer, TXU management gave a detailed financial plan to certain credit rating agencies for the purpose of facilitating the agencies' determinations of whether an increase in TXU's annual dividend would adversely affect the corporation's credit rating. On October 13, 2004, the final day of the tender offer, F&C tendered 425,000 of its 525,000 Corporate Units to TXU for total proceeds of $22,219,000, and Haiduk tendered 5,000 Corporate Units for total proceeds of $260,093.89 and 5,000 PRIDES for total proceeds of $261,103.88.

On October 19, 2004, six days after the end of the tender offer period, TXU management provided materials to the Board proposing a change in dividend policy, and on October 21, 2004, management recommended a 350% increase of the annual dividend on common stock and a 400% increase in the stock repurchase program. In the interim between management's provision of the materials to the Board and the final recommendation, TXU management received final reports from the credit rating agencies informing the corporation that an increase in dividend payouts would not adversely affect its credit rating. On October 22, 2004, the Board approved the dividend increase and the stock repurchase program. On October 25, 2004, TXU publicly announced its plan to increase the common stock dividend from $0.50 to $2.25 and to repurchase approximately 50 million shares of TXU common stock. Immediately following the announcement, the per-share value of TXU common stock jumped nearly 20%. The Corpo-

rate Units and the PRIDES experienced correlated increases in value.

On, September 6, 2005, Appellants filed their original class action complaint in the district court, alleging that the Appellees violated federal securities laws and intentionally defrauded Appellants and other similarly situated holders of TXU securities by failing to inform those who participated in the tender offer that a dividend increase and increased stock repurchase was imminent. Appellants' essential theory is that TXU and Wilder failed to inform them of the impending dividend increase in order to induce Appellants to participate in the tender offer before the value of their securities increased. Appellants alleged three causes of action for fraud under the Securities Exchange Act: (1) a violation of Section 14(e)[1]; (2) a violation of Section 10(b)[2] and Rule

---

[1] Section 14(e) of the Securities Exchange Act makes it unlawful:

> for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

15 U.S.C. § 78n(e).

[2] Section 10(b) of the Exchange Act provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so regis-

10b-5[3]; and (3) controlling person liability against Wilder under Section 20(a).[4] Appellees filed a motion to dismiss all of the Appellants' claims on December 16, 2005, which was granted by the district court. Appellants appealed to this court, but while the appeal was pending, the United States Supreme Court issued its decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 127 S. Ct. 2499 (2007), which clarified the pleading standard for scienter un-

---

> tered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b).

[3] SEC Rule 10b-5, promulgated pursuant to Section 10(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

[4] Under Section 20(a), a person who exerts control over a person who violates any provision of the Securities Exchange Act can be held jointly and severally liable with the primary actor of the underlying securities law violation. 15 U.S.C. § 78t(a). Liability under §20(a) requires the primary actor to be liable for the underlying violation, and here is premised on the Section 10(b) or 14(e) violation.

der the Private Securities Litigation Reform Act of 1995 ("PSLRA"). In response to the *Tellabs* decision, and without addressing the merits of the appeal, this court vacated the district court's judgment and remanded the case for further consideration in light of *Tellabs. Flaherty & Crumrine Preferred Income Fund Inc. v. TXU Corp.*, 242 F. Appx, 253 (5th Cir. 2007).

Appellants filed a second amended complaint on November 26, 2007, restating their original claims and supplementing the complaint with the expert report of Professor Linda Allen, Professor of Finance at the City University of New York, and additional instances of alleged fraudulent misrepresentations.

Appellants also added individual non-class common law fraud claims under Texas state law. Appellees again filed a motion to dismiss Appellants' claims. The district court dismissed the Appellants' federal securities fraud claims on the pleadings under Rule 12(b)(6) because the pleadings failed to give rise to a strong inference of scienter under the standard articulated in *Tellabs* and dismissed their common law fraud claim for failure to plead fraud with particularity as required by Rule 9(b). The instant appeal followed.

II.

A district court's dismissal of federal securities law claims under Rule 12(b)(6) is reviewed de novo. *Herrmann Holdings, Ltd. v. Lucent Tech. Inc.*, 302 F.3d 552, 557-58 (5th Cir. 2002); *Cent. Laborers' Pension Fund v. Integrated Elec. Servs., Inc.*, 497 F.3d 546, 550 (5th Cir. 2007). A dismissal for failure to state fraud with particularity as required by Rule 9(b) is a dismissal on the pleadings for failure to state a claim, and is also reviewed de novo. *Shushany v. Allwaste, Inc.*, 992 F.2d 517, 520 (5th Cir. 1993).

Rule 12(b)(6) authorizes dismissal of a complaint for "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6). "To survive a Rule 12(b)(6) motion, the plaintiff must plead 'enough facts to state a claim to relief that is plausible on its face". *In re Katrina Canal Breaches Litigation*, 495 F.3d 191, 205 (5th Cir. 2007) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)).

Rule 9(b) states that "in alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Fed. R. Civ. P. 9(b). This Circuit's precedent interprets Rule 9(b) strictly, requiring the plaintiff to "specify the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent." *Williams v. WMX Techs., Inc.*, 112 F.3d 175, 177 (5th Cir. 1997); *Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 412 (5th Cir. 2001).

In order to state a claim for fraud under Section 10(b) and Rule 10b-5 of the Securities Exchange Act, a plaintiff must allege, in connection with the purchase or sale of securities, (1) a misstatement or an omission (2) of a material fact (3) made with scienter (4) on which the plaintiffs relied (5) that proximately caused the plaintiffs injury. *R2 Invs. LDC v. Phillips*, 401 F.3d 638, 641 (5th Cir. 2005). The elements of a claim under Section 14(e), which applies to tender offers, are identical to the Section 10(b)/Rule 10b-5 elements. *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 605 (5th Cir. 1974).

. The Private Securities Litigation Reform Act ("PSLRA"), which governs federal securities fraud claims, requires that a plaintiff in a securities fraud case must, for "each act or omission alleged" to be

false or misleading, "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2); *see also Ind. Elec. Workers' Pension Trust Fund IBEW v. Shaw Group, Inc.*, 537 F.3d 527, 533 (5th Cir. 2008); *Zonagen*, 267 F.3d at 407 ("[A] plaintiff alleging a section 10(b)/Rule 10b-5 claim must now plead specific facts giving rise to a strong inference of scienter." (citations omitted)). The PSLRA also incorporates the Rule 9(b) requirements into the pleading standard for federal securities fraud claims. *Abrams v. Baker Hughes Inc.*, 292 F.3d 424, 431 (5th Cir. 2002). Under the PSLRA, the court considers whether all the facts and circumstances, taken together, give rise to a strong inference of scienter. *Id.*; *Zonagen*, 267 F.3d at 425.

Scienter, in the context of securities fraud, is defined as "an intent to deceive, manipulate, or defraud or that severe recklessness in which the danger of misleading buyers or sellers is either known to the defendant or is so obvious that the defendant must have been aware of it." *R2 Invs.*, 401 F.3d at 643; *see also Plotkin v. IP Axess Inc.*, 407 F.3d 690, 697 (5th Cir. 2005) ("[A] securities fraud plaintiff must prove that the defendant either consciously misbehaved . . . or was so severely reckless that it demonstrates that the defendant must have been aware of the danger of misleading the investing public."). "Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care." *R2 Invs.*, 401 F.3d at 643 (quotation omitted). In *Tellabs*, the Supreme Court clarified the standard for pleading a "strong inference" of scienter. *Tellabs*, 127 S. Ct. at 2509-10. This Circuit has recently inter-

preted *Tellabs* as requiring a "three step approach to reviewing scienter allegations on a motion to dismiss a federal securities fraud case pursuant to the PSLRA":

> First, the allegations must, as in federal pleadings generally, be taken as true. Second, courts may consider documents incorporated in the complaint by reference and matters subject to judicial notice. The facts must be evaluated collectively, not in isolation, to determine whether a strong inference of scienter has been pled. Third, a court must take into account plausible inferences opposing as well as supporting a strong inference of scienter. The inference of scienter must ultimately be "cogent and compelling," not merely "reasonable" or "permissible."

Ind. Elec., 537 F.3d at 533 (citing *Tellabs,* 127 S. Ct. at 2509-10). In addition, "omissions and ambiguities count against inferring scienter, for plaintiffs must 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.' *Tellabs*, 127 S. Ct. at 2511 (citation omitted).

Although we have stated that allegations of motive and opportunity standing alone will not suffice to meet the scienter requirement, motive and opportunity allegations may meaningfully enhance the strength of the inference of scienter. *Ind. Elec.*, 537 F.3d at 533 (citing *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 368 (5th Cir. 2004)). We have rejected the group pleading approach to scienter and instead look to the state of mind of the individual corporate official or officials "who make or issue the statement (or order or approve it or its making or issuance, or who furnish information or

language for inclusion therein, or the like) rather than generally to the collective knowledge of all the corporation's officers and employees acquired in the course of their employment." *Id.*

III.

Appellants point to several statements made by either TXU or Wilder which they assert violate federal securities laws. For each of these statements, we must evaluate the scienter allegations pertinent to each and determine whether the facts, evaluated collectively, support a "cogent and compelling" inference that Appellees acted with intent to deceive, manipulate, or defraud or acted with severe recklessness. *See Ind. Elec.*, 537 F.3d at 533-34. In evaluating whether scienter has been established, we will consider the complaint, documents incorporated in the complaint by reference, and matters subject to judicial notice. *Id.* This evaluation must take into account plausible inferences opposing as well as supporting a strong inference of scienter. *Id.*

Appellants urge that, in accepting the tender offer, they relied on the representation originally stated in TXU's May 2004 press release indicating that TXU did not anticipate a dividend increase until 2006, when certain financial benchmarks were reached. Appellants do not clearly delineate between whether they allege an affirmative misrepresentation or an omission. In their second amended complaint, Appellants pointed to various statements made after the May 2004 press release which they allege do not contain a sufficient disclosure of the impending dividend increase or affirmatively misstate that no dividend increase will occur until after certain financial benchmarks are reached.

The first of these statements, issued in the tender offer materials on September 15, 2004, stated:

> As a part of its capital management and restructuring program and considering current business and market conditions, TXU Corp.'s management is evaluating whether it should recommend to the TXU Corp. Board of Directors that they reevaluate TXU Corp.'s current common stock dividend policy. TXU Corp. cannot predict the outcome of management's evaluation, when, if at all, management would make a recommendation to the Board of Directors to change the current common stock dividend policy, or what management's recommendation might be. In addition to any recommendation from management, the Board of Directors may consider other relevant factors in determining if and when to make a change in TXU Corp.'s common stock dividend policy.

Appellants contend that this statement is misleading because, although it does state that the dividend policy is under review, it does not sufficiently disclose the alleged "steps taken to increase the TXU dividend" upon completion of the tender offer.

The second statement that Appellants point to was made by Wilder at the Merrill Lynch Global Power & Gas Leaders Conference on September 28, 2004, during the tender offer period.[5] Wilder presented a power point presentation, which included a slide that described TXU's capital allocation policy. The slide stated that the "dividend payout" was "under review." The statement concerning the dividend payout was

---

[5] This presentation was incorporated into a Form 8-K filed with the SEC on September 28, 2004.

contained in a flow chart and was preceded by a statement that "debt reduction" was to continue until certain financial goals had been met. An arrow pointing toward the "dividend payout" section flowed from the "debt reduction" section of the chart. Appellants contend that this flow chart indicated that the "dividend payout" step would not take place until the "debt reduction" goals had been met. Appellants contend that at the time Wilder made this statement, he knew (1) that the financial benchmarks would not be met before the dividend was increased and (2) that significant steps had been taken to increase the dividend which were not communicated sufficiently by the statement that the dividend policy was "under review." Appellants also contend that Appellees' failure to "retract" the May 2004 statement concerning the dividend policy violated federal securities' laws.

In addition to the facts pleaded in the their complaint, Appellants reference statements made in a January 18, 2005 letter (appended to their complaint) written by then TXU Associate General Counsel David Poole (the "Poole letter")[6] and conclusions in an expert report prepared by Professor Linda Allen (the "Allen Report") which Appellants claim provides evidence that at the time of the tender offer, Appellees were fully aware of the impending dividend increase.

---

[6] Appellants contend that the statements in the Poole letter should not be considered when evaluating opposing inferences. Appellants fail to acknowledge that because they attached the letter to their complaint (not to mention referenced the letter in the report of their own expert), it is relevant for the purposes of evaluating a motion to dismiss. *See Tellabs*, 127 S. Ct. at 2509 (stating that, in the context of a motion to dismiss, courts may consider documents incorporated in the complaint by reference when evaluating whether scienter has been established).

In the Poole letter, TXU's counsel stated that management had been contemplating a change in dividend policy since August 2004, but did not make a final decision until after the close of the tender offer on October 13. The Poole letter also asserted that TXU's management would not make a decision concerning the dividend policy until they had received information from certain credit rating agencies, evaluating the impact of changes in dividend policy and capitalization on the credit ratings of debt securities of TXU Corp. and its subsidiaries. Appellants contend that this explanation, advanced here by the Appellees, is implausible, pointing to conclusions made in the Allen Report. By comparing the TXU restructuring and dividend policy changes with those of other companies and evaluating the dates put forth in the Poole letter, the Allen Report concludes that—despite the fact that the agencies had not given any official evaluation of the dividend increase—TXU senior management likely already knew during the tender offer period that the credit rating agencies would not downgrade its issuer rating based on the common share dividend increase. The Allen Report also concludes, based on Allen's evaluation of the general credit rating process of major credit rating agencies, that the credit agency review could not be completed between October 12, 2004 (the date on which Appellees furnished the credit agencies with paperwork concerning the proposed dividend increase) and October 19, 2004, two days before management recommended the increase.

Although the timing of the dividend increase, which was recommended by TXU management just eight days after the close of the tender offer, is suspect, Appellants have not provided facts sufficient to support a "cogent and compelling" inference that Ap-

pellees made any statements intentionally or recklessly to mislead TXU's investors. In fact, it is not clear that Appellees ever issued a materially misleading statement or omission of fact concerning the dividend policy. The close proximity of the dividend increase to the end of the tender offer, though it provides some support for an inference of scienter, is not sufficient, without more, to establish a strong inference of the requisite intent. *See In re Digital Island Sec. Litig.*, 223 F. Supp. 2d 546, 555-56 (D. Del. 2002), aff'd, 357 F.3d 322 (3d Cir. 2004) (holding that the fact that the offeror company disclosed two successful transactions within weeks after tender offer was completed does not establish that company had knowledge of these transactions at time tender offer was made).

Appellants contend that they relied on the May 2004 press release which stated that a dividend increase was not likely until 2006 when certain financial benchmarks had been made, but reserved the right of the management to consider other factors in determining if and when to change the dividend policy. Appellants have not presented any evidence of scienter with regard to this statement. There is no evidence that at the time this statement was made in May 2004, TXU management, specifically Wilder, was aware or should have been aware that TXU planned to increase the dividend prior to the financial benchmarks being reached.

The second statement pointed to by Appellants, made at the start of the tender offer period, was that the dividend policy was "under review." Appellants contend that this statement was made to mislead investors because at the time it was made, substantial steps had been taken toward a dividend increase

which warranted a more substantial disclosure or a "retraction" of the May 2004 press release statements. Again, Appellants' evidence does not support a strong inference that, on the date this statement was issued, Appellees knew and were at least reckless in failing to disclose that there was an impending dividend increase. Although the Allen Report provides some support for the notion that TXU's management likely made preparations for the dividend increase before the close of the tender offer, such preparations do not support a cogent and compelling inference that Wilder or other TXU management were intentionally or recklessly misleading investors. In fact, the statement that the dividend policy was "under review" conveyed that TXU had taken some steps in evaluating a change in the dividend policy.

The precedent of this court does not support the notion that TXU's disclosure that its policy was "under review" was insufficient, let alone fraudulent, under federal securities laws. TXU had disclosed that its dividend policy was "under review," but that it could not predict if, or when, management would ultimately recommend a dividend increase. TXU management did not recommend the dividend increase until sometime after October 19, 2004 and the Board did not actually approve a dividend increase until October 22, 2004. Both of these dates fell after the expiration of tender offer on October 13, 2004. This court's precedent advises that a "middle course" is proper when making disclosures concerning future plans which have not been fully determined in the context of a tender offer. *Susquehanna Corp. v. Pan Am. Sulphur Co.*, 423 F.2d 1075, 1085-86 (5th Cir. 1970) (holding that a tender offeror "is not required to make predictions of future behavior, however tentatively phrased, which may cause the offeree or the

public investor to rely on them unjustifiably"). TXU could not have disclosed that a dividend increase was likely during the tender offer without running a risk of liability if the dividend increase was not ultimately approved. *See id.* The statement that the dividend policy was "under review" appears to be a statement that, although vague, accurately represents the state of the dividend policy during the tender offer period. Furthermore, given that the May 2004 press release stated that the Board could consider factors other than the outlined financial benchmarks when determining whether to change the dividend policy, the statement in the tender offer materials that the dividend policy was currently "under review" was entirely consistent with the press release, and obviated the need to retract the May 2004 representations.

The statement made by Wilder during his presentation provides a closer question as to whether the Appellants have established scienter. Appellants contend that Wilder's presentation reiterated the structure stated in the May 2004 press release, conveying that a dividend increase was contingent upon the completion of certain financial benchmarks. In order to satisfy the scienter requirement, Appellants must establish that Wilder made this representation knowingly or recklessly in order to mislead investors.

In the first instance, there is a question as to whether Wilder's presentation was a misstatement. Although the phrase "dividend payout" is contained in a flow chart which is preceded by the "debt reduction" step, the dividend payout step does affirmatively state that it is presently "under review," consistent with TXU's prior disclosures.[7] Even assuming

---

[7] In addition, the chart does not ever explicitly state that the various steps are dependent upon one another such that the

that the presentation was a misleading statement concerning the dividend policy, Appellants have not provided evidence to support a strong inference of scienter. Appellants again point to the Allen report, which provides some circumstantial evidence that Wilder may have known at the time of the presentation that a dividend increase was imminent. Appellants also point to Wilder's position in TXU, and assert that as CEO he must have been present during Board discussions of a possible dividend increase. Appellants also contend that because Wilder was a TXU stockholder, he stood to benefit from the repurchase of Appellants' securities at a low price. This court, in applying Tellabs and the pleading standards of the PSLRA, has discounted similar types of evidence against company executives as insufficient to establish scienter. *Ind. Elec.*, 537 F.3d at 535 (holding that "pleading[s] of scienter may not rest on the inference that defendants must have been aware of the misstatement based on their positions with the company"); *see also id.* at 543-44 (holding that monetary rewards for executives tied to company performance are standard and "can hardly be the basis on which an allegation of fraud is predicated").

Even assuming Wilder was aware that the Board was contemplating a dividend increase, this knowledge alone would not suffice to establish that Wilder intended to deceive investors or was reckless in revealing only that the dividend policy was under review at the time of the tender offer. *Shivangi v. Dean Witter Reynolds, Inc.*, 825 F.2d 885, 889 (5th Cir. 1987) (holding that "knowledge of omitted facts does not itself establish scienter"). These motive alle-

---

dividend policy could not be evaluated until the other capital allocation goals had been achieved.

gations, in conjunction with the conclusions of the Allen report and the timing of the dividend increase, provide a basis for some inference of fraud, but this inference is merely permissible, and does not rise to the "cogent and compelling" level required by *Tellabs*. Even if Wilder was negligent in representing that the dividend payout was contingent upon the completion of certain debt reduction goals, negligence does not suffice for scienter purposes. *Ind. Elec.*, 537 F.3d at 533 (noting that "simple or even inexcusable negligence" does not constitute the requisite state of mind for a federal securities case).

Furthermore, as this court stated in *Indiana Electric*, under *Tellabs*, we are obligated to consider inferences opposing the allegations of fraud. *Id.* Here, it can be inferred that Appellees had not made a final decision concerning a change in the dividend policy during the tender offer period, and were thus truthfully stating that the policy was under review. This constitutes a plausible nonculpable explanation of Appellees' actions. The credit rating agencies' evaluation of the proposed dividend increase—according to the dates in the Poole letter, which was appended to Appellants complaint, and the dates referenced in Appellants' expert report—was not furnished to TXU until after the end of the tender offer period. In addition, TXU management did not recommend a dividend increase, nor did the Board approve one, until after the close of the tender offer. Given that TXU and Wilder did disclose that the dividend policy was "under review" during the tender offer period, the inference of non-fraudulent intent weighs in favor of the Appellees. Although it is a close question, the facts alleged support at most only a permissible inference of scienter. Taking into account all of the facts in the aggregate, as well as inferences opposing frau-

dulent intent, Appellants have failed to raise a strong inference that TXU, and specifically Wilder, acted with the intent to deceive, manipulate, or defraud or acted with severe recklessness in making statements concerning the dividend policy.[8]

IV.

Appellants also alleged a claim for common law fraud under Texas law in their amended complaint. The common law fraud claim was based on the same alleged representations and/or omissions underlying Appellants' federal securities claims. The elements of common law fraud under Texas law are (1) a material misrepresentation; (2) that is false; (3) made with knowledge of its falsity or recklessness as to its truth; (4) made with the intention that it should be acted upon by another party; (5) relied upon by the other party, and (6) causing injury. *Jag Media Holdings Inc. v. A.G. Edwards & Sons Inc.*, 387 F. Supp. 2d 691, 709 (S.D. Tex. 2004); *Ernst & Young, L.L.P. v. Pac. Mut. Life Ins. Co.*, 51 S.W.3d 573, 577 (Tex. 2001).

Appellants contend that the claim should not have been dismissed because the district court found that the second amended complaint adequately specifies with particularity which statements contain the alleged misrepresentation and omissions, when and where those statements were made, why the Appellants believe them to be misleading, and that the al-

---

[8] Appellants' claim against Wilder as a controlling person under Section 20(a) of the Securities Exchange Act of 1934 "is secondary only and cannot exist in the absence of a primary violation." *Southland*, 365 F.3d at 383. Because we have found the pleadings of Sections 14(e), 10(b) and Rule 10b-5 liability inadequate, it must be dismissed.

leged misstatements and omissions were material to the decision to participate in the tender offer. Appellants contend that because common law fraud claims are not subject to the PSLRA scienter requirements, they have adequately pleaded fraud even if their pleading was deficient with regard to scienter under the PSLRA.

It is true that common law fraud claims are not subject to the heightened "strong inference" of scienter standard imposed by the PSLRA. *Dorsey v. Portfolio Equities, Inc.*, 540 F.3d 333, 341 (5th Cir. 2008). However, the claims are still subject to the pleading standard of Rule 9(b). *Id.* ("Although the PSLRA's stricter scienter requirement does not apply to state-law fraud claims, Rule 9(b) nevertheless incorporates an element of scienter."). This court has stated, in the context of a state law securities fraud claim, that:

> In order to adequately plead fraudulent intent, 'a plaintiff must set forth specific facts to support an inference of fraud.' 'Alleged facts are sufficient to support such an inference if they either (1) show a defendant's motive to commit securities fraud or (2) identify circumstances that indicate conscious behavior on the part of the defendant.'

Herrmann Holdings, 302 F.3d at 565 (5th Cir. 2002) (quoting *Lovelace v. Software Spectrum Inc.*, 78 F.3d 1015, 1018 (5th Cir. 1996)).

Appellants contend that TXU and Wilder had sufficient motive to fraudulently induce investors to participate in the tender offer by withholding information about the dividend increase—namely to complete the tender offer and increase the value of Wilder's personal stock holdings. However, this court has held that certain motives alleged, especially those univer-

sal to corporations and their officers, do not suffice to establish an inference of fraud under Rule 9(b). *Herrmann Holdings*, 302 F.3d at 565-66 (holding that allegations of delay in order to benefit therefrom were insufficient); *Melder v. Morris*, 27 F.3d 1097, 1102 (5th Cir. 1994) (holding that alleged motive to successfully bring to fruition offerings and enhance the value of the securities at issue was insufficient to establish inference of fraud); *Tuchman v. DSC Commc'ns Corp.*, 14 F.3d 1061, 1068 (5th Cir. 1994) (holding that motive to inflate stock price and value of defendants investments was insufficient to establish scienter under Rule 9(b)). In light of this court's precedent, the motive attributed to Appellees by Appellants—the desire to complete a financially successful tender offer—is insufficient to establish an inference of fraud under Rule 9(b).

In the alternative, the complaint also failed to plead specific facts demonstrating "conscious behavior," which according to our precedent employs an even "more stringent standard" than the motive requirement. *Lovelace*, 78 F.3d at 1018-19 & n.2. Appellants contend that Wilder was in a position that demonstrated close personal involvement with the alleged fraud sufficient to show that Wilder made any misrepresentation consciously. Appellants cite this court's opinion in *Dorsey*, in which we held that the defendants, by virtue of their places as president and director of two very small businesses employing a total of eight workers in which they ran all day-to-day operations, could be imputed with knowledge of the company's failure to make secured loans. 540 F.3d at 342-43. The factual situation here does not approximate that in *Dorsey*. There are no special circumstances that require an assumption of Wilder's fraudulent intent because of his place as CEO of TXU, a

large company with a complex system of management and decision-making. The facts plead by Appellants do not demonstrate that Wilder made any conscious misrepresentation concerning the dividend policy. Because Appellants failed to adequately allege fraudulent intent as required by Rule 9(b), the district court did not err in dismissing the claim for common law fraud.

For the foregoing reasons, the judgment of the district court is AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

[Filed April 8, 2009]

No. 08-10414
D.C. Docket No. 3:05-CV-1784

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED; FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND INCORPORATED; FLAHERTY & CRUMRINE/CLAYMORE PREFERRED SECURITIES INCOME FUND INCORPORATED; STAN HAIDUK

Plaintiffs-Appellants,

v.

TXU CORP; C. JOHN WILDER,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas at Dallas

---

JUDGMENT

Before KING, BENAVIDES, and CLEMENT, *Circuit Judges.*

This cause was considered on the record on appeal and was argued by counsel.

It is ordered and adjudged that the judgment of the District Court is affirmed.

IT IS FURTHER ORDERED that plaintiffs-appellants pay to defendants-appellees the costs on appeal to be taxed by the Clerk of this Court.

ISSUED AS MANDATE: 30 APR 2009.

APPENDIX C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3:05-CV-1784-G ECF

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED, *et al.*,
Plaintiffs,

v.

TXU CORP. AND C. JOHN WILDER,
Defendants.

MEMORANDUM OPINION AND ORDER

Before the court are the following motions: (1) the motion of the defendants, TXU Corporation ("TXU")[1] and C. John Wilder ("Wilder") (collectively, "the defendants"), to dismiss the plaintiffs' second amended class action complaint; (2) the motion of the defendants to strike the report of Linda Allen; (3) the motion of the plaintiffs, Flaherty & Crumrine Preferred Income Fund, Inc., Flaherty & Crumrine Preferred Income Opportunity Fund, Inc., Flaherty & Crumrine/Claymore Preferred Securities Income Fund, Inc., and Stan Haiduk (collectively, "the plaintiffs"),

---

[1] TXU Corporation was purchased in September of 2007, and though the company has since changed its name to Energy Future Holdings Corp., the court will refer to the defendant corporation as "TXU" throughout.

for a hearing;[2] (4) the defendants' motion to dismiss count 4 of the plaintiffs' second amended class action complaint; and (5) the plaintiffs' motion to strike the defendants' motion to dismiss count 4 of the second amended complaint.

For the reasons discussed below, the motion of the defendants to dismiss the plaintiffs' second amended complaint is granted, the motion to strike the report of Linda Allen is denied, the motion for hearing is denied, the motion to dismiss count 4 of the plaintiffs' complaint is granted, and the plaintiffs' motion to strike is denied.

1. BACKGROUND

The plaintiffs originally filed this suit on September 6, 2005. Plaintiffs' Original Class Action Complaint ("Original Complaint"); Docket Entry # 1. After the plaintiffs amended their complaint on November 28, 2005, the defendants filed their first motion to dismiss on December 16, 2005. *See* Docket Entry # 21. On August 30, 2006, this court granted the defendants' motion to dismiss, and the plaintiffs appealed to the Fifth Circuit Court of Appeals. *See* Docket Entry #33; Docket Entry # 35.

While the appeal was pending, the United States Supreme Court issued its decision in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,—U.S.—127 S.Ct. 2499 (2007), which clarified the pleading standard for scienter under the Private Securities Litigation Reform Act ("PSLRA"). In response to the *Tellabs* decision, and without addressing the merits of the

---

[2] The plaintiffs seek a hearing on the defendants' motion to dismiss pursuant to local rule 7.1(g). *See* Docket Entry # 54. However, the court does not find that an evidentiary hearing would be helpful. Therefore, the motion for hearing is denied.

plaintiffs' appeal, the Fifth Circuit vacated[3] this court's judgment and remanded the case for further consideration in light of *Tellabs*. See generally *Flaherty & Crumrine Preferred Income Fund Inc. v. TXU Corp.*, 242 Fed. Appx. 253 (5th Cir. 2007).

The plaintiffs then filed a second amended complaint on November 26, 2007, for the most part restating the same facts they initially alleged, though supplementing the complaint with the expert report of Linda Allen ("Allen report") and additional instances of alleged fraudulent misrepresentations. *See generally,* Plaintiffs' Second Amended Complaint ("Second Amended Complaint"). On December 14, 2007, the defendants filed a motion to dismiss, as well as a motion to strike the Allen report. *See* Defendants' Motion to Dismiss Amended Complaint in Light of *Tellabs* and to Strike Report of Linda Allen and Brief in Support ("Motion to Dismiss"). Over a month later, on January 29, 2008, the defendants filed an additional motion to dismiss the plaintiffs' common law fraud claim. *See* Defendants' Motion to Dismiss Count Four of Plaintiffs (sic) Amended Complaint (Common-Law Fraud) or for Judgment on the Pleadings and Brief in Support ("Second Motion to Dismiss"). Finally, the plaintiffs moved to strike the defendants' second motion to dismiss. *See* Plaintiffs' Amended Motion to Strike Defendants' Second Motion to Dismiss, and Alternative Motion for Enlargement of Time to Respond ("Plaintiffs' Motion to Strike").

---

[3] The plaintiffs erroneously stated in their response that the Fifth Circuit *reversed* this court's prior decision. *See* Plaintiffs' Opposition to Defendants' Motion to *Dismiss* Second Amended Complaint at 2.

In the second amended complaint, the plaintiffs once again allege three causes of action under the Securities Exchange Act: (1) violation of Section 14(e);[4] (2) violation of Section 10(b) and Rule 10b-5;[5] and (3) controlling person liability against Wilder, TXU's chief executive officer, under Section 20(a).[6] Second Amended Complaint ¶¶ 131-141. These are all claims of fraud. Additionally, and in the alternative, the plaintiffs have alleged a fourth cause of action for common law fraud. *Id.* ¶¶ 142-148.

---

[4] Section 14(e), as amended by the Williams Act of 1968, makes it unlawful for "any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation." Second Amended Complaint ¶ 132 (quoting 15 U.S.C. § 78n(e)).

[5] Rule 10b-5, promulgated to facilitate the enforcement of Section 10(b), makes it illegal for any person "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading . . ." Second Amended Complaint ¶ 136 (quoting 17 C.F.R. § 240.10b-5).

[6] A person who exerts control over a person who violates any provision of the Securities Exchange Act can be held jointly and severally liable with the primary violator. Second Amended Complaint ¶ 139; 15 U.S.C. § 78t(a). Controlling person liability under Section 20(a) requires an underlying violation by the controlled person; thus, if the case against the corporate defendant is dismissed, the case against Wilder must also be dismissed. *Southland Securities Corporation v. INSpire Insurance Solutions Inc.*, 365 F,3d 353, 383-84 (5th Cir. 2004); *In re Enron Corporation Securities, Derivative & "ERISA" Litigation*, 439 F. Supp. 2d 692, 695 (S.D. Tex. 2006).

Specifically, the plaintiffs allege that the defendants fraudulently misrepresented the temporal proximity and magnitude of a planned stock repurchase program and dividend increase to induce the plaintiffs to participate in a voluntary tender offer to purchase certain convertible securities.[7] *Id.* ¶ 1.

The concept and design of the tender offer emerged out of Wilder's "Three Phase Restructuring Program." *Id.* ¶35. The goal of the program was to strengthen TXU's balance sheet and increase the corporation's financial flexibility. *Id.* ¶ 38. One prong of the program called for the removal of the convertible securities from the market so as to allow TXU to avoid issuing approximately 36 million additional shares of common stock on the securities' conversion dates. *Id.*

On May 18, 2004, months before the tender offer, TXU issued a press release outlining its view of the company's financial restructuring program. *See* Press Release, *attached to* Second Amended Complaint *as* Exhibit E. TXU set forth certain financial benchmarks and stated that:

> "[u]pon reaching the targeted balance sheet strength and financial flexibility, management would recommend that the Board of Directors reevaluate the current dividend policy. . . . Assuming the execution of the business initiatives and transactions described above, and depending

---

[7] Two types of convertible securities were involved in the underlying transaction: (1) corporate units, which were slated for conversion to common stock on November 16, 2004, and November 16, 2005, and (2) Income PRIDES, which were slated for conversion on May 16, 2006. Second Amended Complaint ¶¶23-25. Because both types of securities would eventually convert to common stock, their value on the secondary market was closely tied to the price of TXU's common stock. *Id.* ¶26.

> on market trends in commodity prices, management expects that this capital allocation program will enable management to recommend an increase of the dividend in 2006. In addition to management's recommendation, the Board of Directors may consider other relevant factors in determining if and when to make a change in the dividend policy."

Id. at 111.

The press release indicated that TXU did not anticipate a dividend increase in 2004 or 2005, but noted that the Board might consider other relevant factors. *Id.* Not long after the May press release, TXU began discussions with a financial advisor concerning the common stock dividend and scheduled a board meeting for October 2004 to discuss the possibility of altering the dividend policy. *Id.* ¶48.

On September 15, 2004, TXU announced an issuer tender offer for up to 11,433,285 outstanding corporate units and 8,700,000 outstanding Income PRIDES. *Id.* ¶54. The corporation determined the offering price for each security by applying a factor to the 20-day weighted average price of TXU common stock between September 20, 2004 and October 8, 2004. *Id.* ¶56. This resulted in offering prices that were greater than the securities' market value. *Id.* ¶75. Those prices were announced on October 11, 2004, and the offer was set to expire on October 13, 2004. *Id.* ¶75; Press Release, *attached to* Second Amended Complaint as Exhibit L.

The offer itself (as well as forms filed with the SEC and the associated press release) contained the following language:

> As a part of its capital management and restructuring program and considering current business and market conditions, TXU Corp.'s management is evaluating whether it should recommend to the TXU Corp. Board of Directors that they reevaluate TXU Corp.'s current common stock dividend policy. *TXU Corp. cannot predict the outcome of management's evaluation, when, if at all, management would make a recommendation to the Board of Directors to change the current common stock dividend policy, or what management's recommendation might be.* In addition to any recommendation from management, the Board of Directors may consider other relevant factors in determining if and when to make a change in TXU Corp.'s common stock dividend policy.

Id. ¶59 (emphasis in original). The plaintiffs allege that this language is misleading because the defendants must have known at the time the statements were made that a dividend increase was imminent.[8] *Id.* Furthermore, the plaintiffs allege that the defendants intentionally released the misleading information into the market so as to suppress prices during the offering period, which allowed them to reduce their outstanding debt more cheaply than if the mar-

---

[8] On September 28, 2004, Wilder gave a presentation (the "Wilder Representation") at a conference where he indicated that TXU's dividend policy was under review. *Id.* ¶¶66-67; Merrill Lynch Global Power & Gas Leaders Conference: TXU at 219, *attached to* Second Amended Complaint *as* Exhibit K. The plaintiffs allege that, like the language in the offer, Wilder's presentation understated and misrepresented the likelihood and scale of the dividend increase and stock repurchase. Second Amended Complaint ¶¶69-72.

ket had been aware of the "imminent" dividend increase. *Id.* ¶114.

On October 12, 2004, just one day before the expiration of the offer, TXU management gave a detailed financial plan to certain credit rating agencies for the purpose of facilitating the agencies' determinations of whether an increase in TXU's annual dividend would adversely affect the corporation's credit rating. *Id.* ¶76. The tender offer then closed on October 13, 2004, but not before the plaintiffs had tendered approximately 430,000 corporate units and 5,000 PRIDES at the proposed tender offer prices. *Id.* ¶¶77-79. However, approximately 35% of the tender offerees declined to participate in the offer. *See* Poole Letter, *attached to* Second Amended Complaint *as* Exhibit B, at 62.

TXU experienced a strong third quarter in 2004. *See generally* TXU's October 22, 2004 Form 8-K, *attached to* Motion to Dismiss *as* Exhibit 1. Additionally, TXU completed several significant corporate transactions during the period from May to October of 2004, including divestitures totaling $4.3 billion in cash proceeds. *Id.;* Allen Report, *attached to* Second Amended Complaint *as* Exhibit A, at 19-20. On October 19, 2004, TXU management provided materials to the Board of Directors proposing a change in dividend policy, and on October 21, 2004, management recommended a 350% increase of the annual dividend on common stock and a 400% increase in the stock repurchase program. Second Amended Complaint ¶¶81, 83. In the interim, between management's provision of the materials to the board and the final recommendation, TXU management received final reports from the credit rating agencies informing the corporation that an increase in dividend payouts

would not adversely affect its credit rating. *Id.* ¶82. Accordingly, on October 22, 2004, the board approved the dividend increase and the stock repurchase program. *Id.* ¶87.

On October 25, 2004, TXU publicly announced its plan to increase the common stock dividend from $0.50 to $2.25 and to repurchase approximately 50 million shares of TXU common stock. *Id.* ¶89. Immediately following the announcement, the per-share value of TXU common stock jumped nearly 20%. *Id.* ¶90. The corporate units and the PRIDES experienced a lesser but similar increase in value. *Id.* The plaintiffs allege that the defendants intentionally defrauded them and other similarly situated holders of TXU securities by failing to inform those who participated in the tender offer that a dividend increase and stock repurchase was imminent. *Id.* ¶¶70-72.

II ANALYSIS

A. Motion to Dismiss

1. 12(b)(6) Standard

"To survive a Rule 12(b)(6) motion, the plaintiff must plead 'enough facts to state a claim to relief that is plausible on its face.'" *In re Katrina Canal Breaches Litigation,* 495 F.3d 191, 205 (5th Cir. 2007) (quoting *Bell Atlantic Corp. v. Twombly,*— U.S.—, 127 S.Ct. 1955, 1974 (2007)). "While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiffs obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Bell Atlantic,* 127 S.Ct. at 1964-65 (citations, quotations marks, and brackets omitted). "Factual allegations must be enough to raise a right

to relief above the speculative level, on the assumption that all the allegations in the complaint are true (even if doubtful in fact)." *Katrina Canal,* 495 F.3d at 205 (internal quotation marks omitted) (quoting *Bell Atlantic,* 127 S.Ct. at 1965). "The court accepts all well- pleaded facts as true, viewing them in the light most favorable to the plaintiff." *Id.* (internal quotation marks omitted) (quoting *Martin K. Eby Construction Company v. Dallas Area Rapid Transit,* 369 F.3d 464, 467 (5th Cir. 2004)).

To avoid dismissal, fraud claims under Section 10(b) and 14(e) of the Exchange Act must also satisfy the heightened pleading requirements imposed by Rule 9(b) of the Federal Rules of Civil Procedure. Rule 9(b) states that "[in] alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." FED. R. CIV. P. 9(b). The Fifth Circuit interprets Rule 9(b) strictly, requiring the plaintiff to "specify the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent." *Williams v. WMX Technologies, Inc.,* 112 F.3d 175, 177 (5th Cir.), *cert. denied,* 522 U.S. 966 (1997); *Nathenson v. Zonagen Inc.,* 267 F.3d 400, 412 (5th Cir. 2001).

Additionally, beyond the requirements of Rule 9(b), the PSLRA requires that a plaintiff in a securities fraud case "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). The recent Supreme Court case of *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,*—U.S.—127 S.Ct. 2499 (2007), articulated the proper pleading requirements

for establishing a strong inference of scienter.[9] In *Tellabs,* the Supreme Court held that "[T]o qualify as 'strong' within the intendment of § 21D (b)(2), . . . an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of non-fraudulent intent." *Id.* at 2504-05. The analysis is comparative in nature, and the court must consider "competing inferences rationally drawn from the facts alleged." *Id.* at 2504.

2. *The Plaintiffs' Claims under the Securities Exchange Act*

To state a section 10(b)/Rule 10b-5 claim, a plaintiff must allege, in connection with the purchase or sale of securities, (1) a misstatement or an omission (2) of a material fact (3) made with scienter (4) on which the plaintiff relied (5) that proximately caused the plaintiff injury. *Abrams v. Baker Hughes Inc.,* 292 F.3d 424, 430 (5th Cir. 2002); *R2 Investments LDC v. Phillips,* 401 F.3d 638, 641 (5th Cir. 2005). The elements of a section 14(e) claim are "identical" to the

---

[9] Scienter has been defined by the Supreme Court to be "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193 n. 12 (1976). The Fifth Circuit has held that scienter can be shown by "either intent *or severe recklessness.*" See *Financial Acquisition Partners LP* v. *Blackwell,* 440 F.3d 278, 287 (5th Cir. 2006) (emphasis in original). Severe recklessness "is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, . . . present[ing] a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Central Laborers' Pension Fund v. Integrated Electrical Services Inc.,* 497 F.3d 546, 551 (5th Cir. 2007).

section 10(b)/Rule 10b-5 elements. *Smallwood v. Pearl Brewing Company,* 489 F.2d 579, 605 (5th Cir.), *cert. denied,* 419 U.S. 873 (1974). The aforementioned heightened pleading standards of Rule 9(b) and the PSLRA apply equally to both claims. See *Hollywood Casino Corporation v. Simmons,* No. 3:02-CV-0325-M, 2002 WL 1610598 at *2 (N.D. Tex. July 18, 2002). Accordingly, the court will address both claims simultaneously.

In their second amended complaint, the plaintiffs allege a total of six specific instances where the defendants either affirmatively misrepresented the status of the dividend increase and repurchase program or made material omissions pertinent thereto.[10] The second amended complaint adequately specifies with particularity which statements contain the alleged misrepresentation and omissions, when and where those statements were made, and why the plaintiffs believe them to be misleading. *See* Second Amended Complaint ¶¶35-73. Furthermore, the plaintiffs have adequately demonstrated that the alleged misstatements and omissions were material to the plaintiffs' decision to participate in the tender offer. Second Amended Complaint ¶¶60-63.

Additionally, the plaintiffs have offered the expert report of Professor Linda Allen. The defendants have moved to strike the report on the basis that it is "insufficient" under the standard set forth in *Financial Acquisition Partners LP v. Blackwell,* 440 F.3d 278,

---

[10] These misrepresentations and omissions are denominated in the second amended complaint as "The Dividend Policy Statement," the "Stock Repurchase Statement," the "Dividend Omission," the "Buyback Omission," the "Dividend Representation" and/or the "Wilder Representation." Second Amended Complaint ¶133, 137.

285-86 (5th Cir. 2006), which held that "opinions cannot substitute for facts under the PSLRA." *See* Motion to Dismiss at 16. The court need not address the motion to strike, however, because the content of the Allen report does not affect the ultimate disposition of the case, and as a result the defendants' motion to strike is denied as moot.[11]

The only real issue, once again, is whether the plaintiffs have "state[d] with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). The court now turns to the six specific misrepresentations/omissions alleged by the plaintiffs to determine if TXU acted with the requisite scienter. Each specific misrepresentation/omission will be addressed, with the court considering, as *Tellabs* requires, opposing inferences of non-fraudulent intent. The court will then examine whether the entire quantum of facts establishes scienter. See *Central Laborers'*, 497 F.3d at 555 (examining the "collective impact" of the plaintiffs' allegations); *Abrams*, 292 F.3d at 431 (recognizing that *Zonagen* suggests all allegations should be read together to make a determination of scienter).

a. The Dividend Policy Statement,

The plaintiffs claim that TXU made two misrepresentations in the May 2004 press release by stating that any increase in the TXU common dividend would likely occur in 2006 after certain financial

---

[11] The plaintiffs contend that the Allen report buttresses the argument that the defendants acted with scienter. After reviewing the report, however, the court finds that Professor Allen's assessment of the facts does little to establish a strong inference of scienter.

benchmarks had been met. *See* Second Amended Complaint ¶45; Press Release, *attached to* Second Amended Complaint *as* Exhibit E. The plaintiffs claim that the truthfulness of TXU's press release changed significantly throughout the tender offer period, and that TXU failed to disclose the changes to the interested parties, thus demonstrating scienter. However, cautionary language in the May press release that the Board "may consider other relevant factors" when reaching a decision on the dividend policy weighs against a finding of scienter. Though the plaintiffs urge that "[n]o reasonable investor would disregard" the bulk of the May press release, *see* Plaintiffs' Opposition to Defendants' Motion to Dismiss Second Amended Complaint ("Plaintiffs' Response") at 13, the court notes that nearly 35% of the potential *class did* pass on the tender offer. Poole Letter, *attached to* Second Amended Complaint *as* Exhibit B. at 62.

b. The Stock Repurchase Statement

The plaintiffs argue that TXU's failure to follow the announced plan to repurchase "up to 10 million share of its common stock" demonstrates scienter. Second Amended Complaint ¶50; TXU's Form 8-K, *attached to* Second Amended Complaint as Exhibit F, at 120. Ultimately, management recommended the repurchase of nearly 50 million shares of TXU stock. *See* Second Amended Complaint ¶83. The plaintiffs claim they relied on the estimate of 10 million shares when deciding whether to sell their securities, *id.* ¶¶50-52, but it is unclear to the court how the disparity between 10 and 50 million shares supports a strong inference of scienter. The critical factor would appear to be the amount of the dividend, not the number of shares TXU ultimately decided to repurchase.

c. The Dividend Representation and Wilder Representation

The plaintiffs argue that the "Dividend Representation" and the "Wilder Representation" also show scienter on the part of TXU. *See* Second Amended Complaint ¶¶59-60. The plaintiffs contend that when TXU made the tender offer, TXU was "in a position to know when it would recommend a change in [the] dividend policy to the Board." *Id.* ¶59. Therefore, Flaherty & Crumrine asserts, because TXU did not correct or retract the May 2004 "Dividend Policy Statement," the representations it made during the tender offer demonstrate TXU's intent to deceive the plaintiffs. Plaintiffs' Response at 8-10.

During the tender offer, TXU disclosed that the dividend policy was under review, stating specifically that it "cannot predict the outcome of management's evaluation, when, if at all management would make a recommendation to the Board of Directors to change the current common stock dividend policy, or what management's recommendation might be." Second Amended Complaint ¶ 59; Motion to Dismiss at 7. The plaintiffs ignored the writing on the wall. The mere fact that a board meeting had been scheduled to discuss the dividend policy did not make the increase "imminent"—TXU still needed to obtain information from the credit agencies, and the board still needed to consider that information and make a decision.

The "Wilder Representation" also fails to support a strong inference of scienter. The presentation,[12] which Wilder gave on September 28, 2004, outlines TXU's financial restructuring program, and, consis-

---

[12] *See* Merrill Lynch Global Power & Gas Leaders Conference: TXU, *attached to* Second Amended Complaint *as* Exhibit K.

tent with TXU's previous disclosures, notes that TXU's dividend policy was under review. The fact that Wilder gave a presentation on the 3-phase restructuring program does not provide a strong inference of scienter. Though ultimately the dividend was increased in advance of the program's projection, TXU was not bound to the benchmarks alone. As detailed above, other factors were relevant to the board's decision, and Wilder was not in a position in September of 2004 to speculate as to what that decision might be.

d. The Dividend Omission and Buyback Omission

The "Buyback" and "Dividend" omissions, as alleged by the plaintiffs, stem from the lack of information in the tender offering documents about the "imminent and dramatic increase" in TXU's common stock dividend and the common stock buyback program. Second Amended Complaint ¶62. The court finds little difference between the "dividend representation" and the two omissions urged by the plaintiffs. Flaherty &. Crumrine's insistence that a dividend increase was imminent does not make that the case. For the same reasons articulated in Part II(A)(2)(c), the court finds that the omissions highlighted by the plaintiffs do not established a strong inference of scienter.

e. The Quantum of Facts

The plaintiffs' assertions rest solely on circumstantial evidence—they have no smoking gun to support their allegations; rather, their argument is based on a series of inferences. As proof of the defendants' knowledge that a dividend increase was a foregone conclusion prior to the termination of the tender offer, the plaintiffs proffer the following facts to sup-

plement the specific instances discussed above: (1) TXU (and Wilder specifically) developed the three-stage restructuring plan and stood to benefit financially from a dividend increase; (2) TXU retained a financial advisor; (3) TXU notified the Board of Directors in August of 2004 that a meeting was set for October to discuss the dividend policy; and (4) TXU submitted a detailed financial plan to credit rating agencies to support the dividend increase. Plaintiffs' Response at 11-15.

However, when considering, as *Tellabs* requires, opposing inferences of non-fraudulent intent, the court finds that the plaintiffs have failed to establish a strong inference of scienter. Looking at the contested disclosures from the defendants' perspective, there is ample evidence to support non-fraudulent intent. It appears that the plaintiffs expected TXU to state unequivocally that a dividend increase was on the way. Even if TXU had explicitly stated that the May benchmarks were no longer critical, and if the plaintiffs had declined the tender offer, the court could imagine a suit by the plaintiffs complaining that TXU misled them into *not* participating in the tender offer had a dividend increase not been approved by the board.

The plaintiffs focus on the defendants' failure to "retract" the May benchmarks as evidence of scienter. Plaintiffs' Response at 10. However, TXU's disclosures make it clear that the benchmarks were not the only factor that would be considered. The May press release states that "[i]n addition to the management's recommendation, the Board . . . may consider other relevant factors in determining if and when to make a change in the dividend policy." *See* Second Amended Complaint ¶45.

Furthermore, Wilder's compensation and involvement in the restructuring plan does not weigh for or against a strong inference of scienter. CEOs are expected to develop strategies to improve a company's financial situation, and in exchange for getting results, CEOs expect to be compensated. For any inference of scienter one could draw from Wilder's role in TXU's success, there exists an equally plausible, nonfraudulent inference.

Though the plaintiffs have increased the number of alleged misrepresentations and omissions they attribute to TXU, there is hardly more substance to their current claims than in the initial complaint. There is a fine (but important) distinction between *planning* for a *possible* dividend increase and *concealing an imminent* dividend increase.

To further illustrate the plaintiffs' failure to adequately allege a strong inference of scienter, the court looks to Fifth Circuit PSLRA precedent. The Fifth Circuit addressed the *Tellabs* standard for scienter in *Central Laborers' Pension Fund v. Integrated Electrical Services, Inc.*, 497 F.3d 546 (5th Cir. 2007). In holding that a securities fraud complaint failed to plead scienter with sufficient particularity, the court "examine[d] the[] allegations in *toto* when determining whether [the plaintiff] adequately pleaded scienter." *Id.* at 552. The plaintiff alleged 'insider trading, GAAP violations, failure to fix an accounting error, the making of false statements about internal controls, and pervasive knowledge of accounting problems" throughout the defendant corporation. *Id.* Even after considering the plaintiff's numerous allegations, the court did not find a strong inference of scienter. *Id.* at 555. The allegations in *Central Laborers'* were

far more serious than the disclosures/omissions attributed to TXU in the instant case.[13]

A case in the Southern District of Texas, *In re Cybertronics Inc. Securities Litigation,* 523 F. Supp.2d 547 (S.D. Tex. 2007), also interpreted the scienter pleading requirements post-*Tellabs* and dismissed a shareholder suit under the PSLRA. *In Cybertronics,* the purchasers of the defendant's stock brought suit, alleging that the "defendants made false and misleading statements" regarding the likelihood that the defendant's medical device would be approved for the treatment of depression, the status of the FDA approval process, and the likelihood of payer approval. *Id.* at 550. Holding that the shareholders did not plead facts giving rise to a strong inference of scienter, the court found that "plausible non-culpable aternative[]" inferences outweighed those in support of scienter. *Id.* at 554.

---

[13] See also *Zonagen,* 267 F.3d at 424-26 (pre-*Tellabs* case finding a strong inference of scienter where corporate executives affirmatively misrepresented the patent status of the corporation's only product in order to raise the corporation's stock price); *Abrams,* 292 F.3d at 431-32 (pre-*Tellabs* case refusing to find a strong inference of scienter where company executives affirmatively represented that the corporation had no internal accounting issues the day after two financial officers quit even though it was later revealed that there were significant accounting irregularities at the time—the court noted the lack of internal or external documents revealing scienter); *R2 Investments,* 401 F.3d at 644 (pre-*Tellabs* case refusing to find a strong inference of scienter where the defendants made affirmative misrepresentations regarding the corporation's cash-on-hand situation even though the plaintiffs alleged that specific officials knew that material information was omitted from public disclosures).

Once again, taking all well-pleaded facts and evaluating them holistically, the court does not find a strong inference of scienter attributable to the defendants. On balance, when compared to the other post-*Tellabs* decisions, the facts set forth by the plaintiffs do not demonstrate the sort of fraudulent intent the PSLRA aims to enforce. *Tellabs,* 127 S.Ct. at 2504 (recognizing the "strict[] demand Congress sought to convey in § 21D(b)(2)."). Therefore, counts one, two, and three of the second amended complaint must be dismissed.

3. *Common Law Fraud - Count Four*

The plaintiffs have also alleged, as an alternative to their PSLRA claims, a claim for common law fraud[14] In a second motion to dismiss, filed forty-five days after the initial motion to dismiss, TXU moves to dismiss the common law fraud claims under Rule 12(b)(6). *See generally* Second Motion to Dismiss. In response, the plaintiffs argue that the common law fraud claim is sufficient. In addition, the plaintiffs oppose the motion to dismiss count four on procedural grounds, moving to strike TXU's motion as untimely pursuant to Rule 12(g)(2) of the Federal Rules of Civil Procedure. *See* Plaintiff's Motion to Strike ¶5.

In the defendants' initial motion to dismiss under the PSLRA, there was no mention of dismissing count four of the second amended complaint. The defendants note, however, that the plaintiffs' original complaint, before the *Tellabs* decision, made no men-

---

[14] Under the Securities Litigation Uniform Standards Act ("SLUSA"), 15 U.S.C. § 78bb(f)(1), claims for common law fraud may not be brought in a class action suit. Consequently, the common law fraud claim may only be asserted on behalf of the named plaintiffs.

tion of common law fraud. Defendants' Response to Plaintiffs' Motion to Strike at 3-4. The court finds that the plaintiffs will not be prejudiced by consideration of the second motion to dismiss; addressing the issue now only serves judicial economy—the issue has been briefed and is ripe for determination. Therefore, the plaintiffs' amended motion to strike the defendants' second motion to dismiss count four is denied.

Pleading fraud with particularity requires that a plaintiff specify the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent. *Williams,* 112 F.3d at 177.

In response to the defendants' motion to dismiss, the plaintiffs argue that because common law fraud claims are not subject to the PSLRA scienter requirements, it necessarily follows that they have adequately alleged a cause of action for fraud. *See* Plaintiffs' Opposition to Defendants' Motion to Dismiss Count Four of Plaintiffs' Amended Complaint (Common-Law Fraud) or for Judgment on the Pleadings at 3. Regarding TXU's alleged misrepresentations, the plaintiffs make the conclusory statement that they have explained "precisely when they were made, by whom made, why they were material, why they were misleading, and what the Defendants obtained by making them." *Id.* at 4. However, as discussed above, simply because the plaintiffs were misled, the court does not therefore find TXU's statements to be misleading; the plaintiffs fail to show *how* each statement was fraudulent. *Melder v. Morris,* 27 F.3d 1097, 1100 (5th Cir. 1994). Accordingly, the court is compelled to dismiss the plaintiffs' common law fraud claim.

III. CONCLUSION

For the reasons stated above, the defendants' motions to dismiss are GRANTED, the defendants' motion to strike the report of Linda Allen is DENIED as moot, the plaintiffs' motion to strike the defendants' second motion to dismiss is DENIED, and the plaintiffs' motion for a hearing is DENIED. The plaintiffs' second amended class action complaint is DISMISSED with prejudice for failure to state a claim on which relief can be granted.

SO ORDERED.

April 4, 2008.

/s/ A. JOE FISH
Senior United States District Judge

APPENDIX D

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

Civil Action No. 3:05-CV-1784-G ECF

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED, *et al.*,
Plaintiffs,

vs.

TXU CORP. and C. JOHN WILDER,
Defendants.

JUDGMENT

This judgment is entered pursuant to F.R. CIV. P. 58 and the memorandum opinion and order of this date. For the reasons stated in that memorandum opinion and order, it is ORDERED that the plaintiffs take nothing from the defendants on their claims in this case and that the defendants recover their costs of court.

April 4, 2008.

/s/ A. Joe Fish
A. JOE FISH
Senior United States District Judge

APPENDIX E

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
(DALLAS DIVISION)

Civil Action No. 3-05CV1784-G
ECF JURY TRIAL DEMANDED

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED; FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND INCORPORATED; FLAHERTY & CRUMRINE/CLAYMORE PREFERRED SECURITIES INCOME FUND INCORPORATED, AND STAN HAIDUK,

Plaintiffs,

v.

ENERGY FUTURE HOLDINGS CORP. formerly known as TXU CORP., and C. JOHN WILDER,

Defendants.

PLAINTIFFS' SECOND AMENDED CLASS ACTION COMPLAINT

To The Honorable Judge of the United States District Court:

COME NOW, Plaintiffs Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated, Flaherty & Crumrine Preferred Income Fund Incorporated, Flaherty & Crumrine/Claymore Preferred Securities Income Fund Incorporated, and Stan Haiduk ("Plaintiffs"), who bring this action individually and on behalf of the class of persons defined below, against Defendant Energy Future Holdings Corp. (f/k/a TXU Corp.) ("TXU"), and its former President,

Chief Executive Officer, and Director Defendant C. John Wilder ("Wilder") (collectively, "Defendants"). Plaintiffs for their complaint allege:

NATURE OF THIS ACTION

1. Defendant TXU made a self-tender offer in September 2004 ("the Tender Offer") to purchase two classes of its outstanding convertible debt securities that were scheduled soon for mandatory conversion into TXU common stock. Significantly, however, TXU did not disclose to Plaintiffs and other holders of those securities that TXU planned to both dramatically increase its common stock dividend amount and accelerate its common stock buy-back program, immediately upon closing the Tender Offer. To the contrary, TXU and Wilder—both before and *during* the Tender Offer—led Plaintiffs and the rest of the market to believe the common share dividend and repurchases would only be increased years later, and then only after TXU had reached specific financial benchmarks. However, just nine short days after the Tender Offer closed, TXU adopted a phenomenal 350% increase in its common stock dividend and an extraordinary 400% increase in its common stock buyback program, before any of its publicly represented predicate benchmarks had been met. Plaintiffs were dumbfounded, and the market was surprised by these increases: the TXU common stock price rose 20% immediately intraday on the announcement, to a then-record high closing up to 16% for that day. This was great news for Defendants, particularly Wilder, but not for Plaintiffs and the other investors whom TXU had just snookered into accepting its Tender Offer.

2. To induce participation in TXU's Tender Offer, and as part of a plan to concentrate TXU's common

share count and capital structure making the company an attractive leveraged buy-out target, Defendants repeatedly made false and misleading statements and omissions concerning the imminence of the planned dividend increase and the planned acceleration of TXU's common stock buy-back. These false and misleading misrepresentations and omissions enabled TXU to retire its convertible securities through the Tender Offer at a substantial and artificial discount from their true value. As soon as Defendants had reeled in the convertibles, they tripled the common stock dividend and quadrupled their common share buyback program, with predictable results for their common stock price.

3. TXU and Wilder knew (or were reckless in not knowing) that the representations they made to those from whom they were soliciting the Securities were false and misleading when made, or were rendered false and misleading by immediately subsequent actions taken by Defendants themselves. This is shown below and confirmed in the expert report of Professor Linda Allen ("Allen Report"), attached as Exhibit "A" to the Appendix of Exhibits to Plaintiffs' Second Amended Class Action Complaint (the "Appendix").

4. Evidencing their scienter, TXU and Wilder later sought to cover up their actions through an implausible claim that timing of TXU's dividend increase decision had been dependent upon receipt of post-Tender Offer communications from TXU's credit rating agencies, to the effect that the dividend increase would not adversely affect TXU's overall issuer credit rating. This explanation, first given in a letter from TXU's Senior Vice President and Associate General Counsel David P. Poole ("the Poole Letter"), Appendix Exhibit "B," and later reiterated by

TXU's legal counsel to the United States Court of Appeals for the Fifth Circuit ***is simply not credible and cannot possibly provide a plausible account for the sudden announcement of an increase in common share dividends and buybacks***. *See* Appendix Exhibit "A," Allen Report at App. Ex. 10-13[1]. This excuse is not plausible under the factual chronology set forth below, particularly given certain factual admissions made in the Poole Letter.

5. In these ways, described with particularity below, Defendants' conduct violated federal securities laws governing self-tender offers and market manipulation, and in the alternative constitutes common law fraud against Plaintiffs.

THE PARTIES

6. Plaintiffs Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated, Flaherty & Crumrine Preferred Income Fund Incorporated, and Flaherty & Crumrine/Claymore Preferred Securities Income Fund Incorporated (collectively, "the Flaherty & Crumrine Funds") are each a closed-end management investment company registered under the Investment Company Act of 1940, as amended, the common stock of which trades on the New York Stock Exchange. The Flaherty & Crumrine Funds are Maryland corporations, with their principal place of business in California. Each is advised by Flaherty & Crumrine Incorporated, of Pasadena, CA.

7. The Flaherty & Crumrine Funds are precisely the sort of institutional investors which Congress sought in the Private Securities Litigation Reform

---

[1] Citiations to "App. Ex." indicate the page number in the Appendix were the relevant exhibit can be found.

Act ("PSLRA") to have bring and control federal securities law class actions.

8. Before bringing this claim, the Flaherty & Crumrine Funds, through their corporate counsel, Wilkie Farr & Gallagher, complained bitterly to TXU about the market manipulations at the heart of this lawsuit. Only when TXU provided an unsatisfactory and implausible account of why it withheld material information from those to whom TXU made its Tender Offer, did the Flaherty & Crumrine Funds initiate this litigation. A true and correct copy of the letter from Wilkie Farr & Gallagher (the "Wilkie Fan Letter") is attached to the Appendix as Appendix Exhibit "C" (App. Ex. 63).

9. The Flaherty & Crumrine Funds sought undersigned counsel to represent their interests and those of similarly situated sellers in the Tender Offer.

10. The Flaherty & Crumrine Funds are paying the costs incurred in connection with this litigation, including the fees charged by Professor Allen.

11. Plaintiff Stan Haiduk ("Haiduk") is a resident of and domiciled in Las Vegas, Nevada. Haiduk sought out undersigned counsel in response to the statutory notice required by the PSLRA, to represent his interests and those of similarly situated sellers in the Tender Offer.

12. Defendant Energy Future Holdings Corp. (f/k/a TXU Corp.) is a Texas corporation, with its principal place of business at Energy Plaza, 1601 Bryan Street, Dallas, Texas, 75201-3411. Prior to its acquisition by Texas Energy Future Holdings Limited Partnership, and at all times material to this action, TXU Corp. was a publicly-traded company.

13. Defendant Wilder was, at all times material to this action, the president and chief executive officer of TXU, and is domiciled in Texas.

JURISDICTION AND VENUE

14. The claims asserted herein arise under and pursuant to Sections 14(e), 10(b) and 20(a) of the Exchange Act, (15 U.S.C. §§ 78n(e), 78j(b) and 78t(a)), and Rule 10b-5 promulgated thereunder (17 C.F.R. § 240.10b-5), and under state common law.

15. This Court has jurisdiction over the subject matter of this action pursuant to Section 27 of the Exchange Act (15 U.S.C. § 78aa), 28 U.S.C. § 1331, 28 U.S.C. §1332 and 28 U.S.C. §1367.

16. Venue is proper in this Judicial District pursuant to Section 27 of the Exchange Act (15 U.S.C. § 78aa) and 28 U.S.C. § 1391(b). Most of the acts and transactions alleged herein, including preparation and dissemination of materially false and misleading information and omissions, occurred in this District.

17. In connection with the acts, conduct and other wrongs alleged in this complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including but not limited to the United States mails, interstate telephone communications, and a facility of a national securities exchange.

18. The matter in controversy exceeds, exclusive of interest and costs, the sum of $75,000 as to each of the Flaherty & Crumrine Funds, and as to Haiduk.

GENERAL ALLEGATIONS

A. The Leveraged Buy-Out of TXU

19. TXU Corp. was a publicly-traded, Dallas-based energy company that owned and managed a portfolio of competitive and regulated energy businesses, primarily in Texas.

20. In February, 2007, a group of investors led by Kohlberg Kravis Roberts & Co., Texas Pacific Group, and Goldman Sachs Capital Partners announced a proposed private equity leveraged buy-out of TXU Corp. The deal ("the Leveraged Buy-Out"), valued at approximately $32 billion, was the largest private-equity acquisition in United States history.

21. On or about September 7, 2007, Texas Energy Future Holdings Limited Partnership merged with TXU Corp., which subsequently changed its name to Energy Future Holdings Corp. (In this Second Amended Complaint, the Defendant Energy Future Holdings Corp. (f/k/a TXU Corp.) is referred to as "TXU").

22. Under the terms of the acquisition, holders of TXU Corp., common stock were entitled to receive $69.25 in cash for each common share held. On or about October 10, 2007, shares of TXU common stock ceased trading on the New York and Chicago Stock Exchanges and were delisted.

B. The Securities

23. Before the Leveraged Buy-Out, TXU had issued two classes of publicly-traded debt instruments, convertible into shares of TXU common stock, and scheduled for mandatory conversion at a future date. The convertible debt securities at issue in this action were known as TXU Corp., 8.75% Series C units

("the Corporate Units"), and Income PRIDES ("the PRIDES," and together with the Corporate Units, "the Securities").

24. At September 15, 2004, TXU had issued and outstanding approximately 11 million Corporate Units, one half of which were scheduled for imminent mandatory conversion to TXU common stock on November 16, 2004, with the balance scheduled for mandatory conversion on November 16, 2005.

25. At September 15, 2004, TXU also had issued and outstanding approximately 8.7 million convertible PRIDES, which were scheduled for mandatory conversion to TXU common stock on May 16, 2006.

26. During the time relevant to this action, there was a secondary market for the Securities. Because of the convertible nature of the Securities, their market price highly correlated to the market price of TXU common stock. In addition to their conversion feature, the Securities paid a substantial rate of interest, and were attractive to yield-oriented investors like Plaintiffs. The Securities offered a good current yield, and the possibility of price appreciations if TXU's common share price went up. Sophisticated investors, such as lead plaintiff Flaherty & Crumrine, are highly attentive to the potential impact of dividend payments on the yield rate of instruments such as the Securities, which are disproportionately held by a specialized group of similar sophisticated investors.

27. At September 15, 2004, Flaherty & Crumrine Funds held and managed 425,000 Corporate Units, CUSIP No. 873168504.

28. At September 15, 2004, Haiduk held 5,000 Corporate Units and 5,000 PRIDES.

C. Wilder's Retention, Compensation, and Unexpected Early Departure

29. TXU hired Wilder as its President and Chief Executive Officer under an employment agreement effective February 21, 2004. As shown below, Wilder was, through his employment agreement, extremely well-compensated for his approximately three years at the helm of TXU, with most of his compensation tied to the performance of TXU's common stock price. Under his employment agreement, and before the Tender Offer, Wilder had obtained beneficial ownership of 1,800,000 shares of TXU common stock, more than all senior managers and all directors of TXU *combined*. Thus motivated, Wilder spent his time planning and positioning TXU for the Leveraged Buy-Out, which would prove wildly lucrative for him personally.

30. Wilder's employment agreement provided for a five year term as TXU's President and Chief Executive Officer. TXU agreed to use its best efforts to cause Wilder to be elected as Chairman of the TXU Board of Directors effective with TXU's 2005 annual shareholders' meeting. The agreement entitled Wilder to a minimum annual base salary of $1,250,000; *plus* target annual bonuses under the TXU Annual Incentive Plan of 200% of his base salary (except that Wilder was guaranteed receipt of the full $2,500,000 bonus for 2004); *plus* two initial performance-based restricted stock awards of 150,000 shares each, one with a two-year performance period and the other with a three-year performance period; *plus* annual performance-based restricted stock awards of 150,000 shares thereafter; *plus* TXU established a trust to hold 500,000 more shares of TXU common stock purchased by TXU to be distributed to

Wilder in equal portions on the third and sixth anniversaries of the agreement unless otherwise deferred; *plus* Wilder received a signing bonus of $1,000,000, and was given substantial fringe benefits, including use of TXU's aircraft, reimbursement for temporary living expenses, and relocation benefits, as well as tax reimbursement payments defraying any personal income taxes levied on these benefits. Finally, under the agreement TXU also awarded Wilder 1,000,000 phantom units of TXU common stock, should certain common TXU stock target prices be met and sustained. These phantom shares fully vested during June 3-7, 2004, before the Tender Offer.

31. During Wilder's first year as TXU's CEO, in which the Tender Offer took place, he received nearly $55 million in total compensation, the bulk of which was common stock awards.

32. Wilder ultimately left TXU after lining up the Leveraged Buy-Out without prior authority from the TXU Board of Directors ("the Board"). Indeed, as revealed in the TXU buyout proxy statement, Wilder waited at least two—and perhaps as many as three weeks—before alerting any other Board member that he was individually and secretly negotiating with two private-equity firms to sell them TXU. According to the proxy statement, it was Wilder himself (and not the TXU Board) who negotiated and signed a confidentiality agreement between TXU and the private equity suitors.

33. After negotiating and binding the Leveraged Buy-Out, with terms highly favorable to himself personally, Wilder announced his resignation from TXU.

34. As a result of the Leveraged Buy-Out and his concurrent resignation, Wilder received $277 million in proceeds from the TXU common stock he acquired

during three years as CEO of TXU and a severance package worth an additional $10.5 million.

D. Wilder's Three-Phase Restructuring Program

35. To position TXU for the Leveraged Buy-Out, in the Spring of 2004 Wilder introduced what he called his "Three Phase Restructuring Program."

36. Phase One of Wilder's Three-Phase Program called for restructuring TXU's operations by, among other things, selling certain inefficient TXU subsidiaries and business units. Phase Two focused on investment in TXU's core business and improvements in customer service, reliability and increased return on capital investment. Phase Three was dedicated to capital allocation and growth.

37. TXU, like all utilities, was a voracious user of capital, most of which was debt capital. Cheap access to credit markets is important for TXU's long-term success. Wilder's Three Phase Restructuring Program was a radical proposal to transform TXU, all aspects of which, given TXU's then financial condition and low insurer credit rating, would require continuous and close coordination with TXU credit rating agencies. *See* Appendix Exhibit "A," Allen Report at App. Ex. 13-14. TXU could always borrow, but its low cost of funds was dependent on keeping an "investment grade" issuer credit rating.

38. TXU has admitted that one objective of the "Three Phase Restructuring Program" had been to remove convertible securities (like the Securities) from TXU's balance sheet, and thus "avoid[] the issuance of as many as 36 million additional shares of TXU Corp. common stock." The fewer common shares, the higher the price of each remaining share.

This objective, like other aspects of TXU's Restructuring Program, would have been discussed with TXU's credit rating agencies from the very outset of the Program. Appendix Exhibit "Q," November 29, 2004 Press Release at App. Ex. 258.

E. The Significance of the Dividend Payout to Holders of the Securities

39. One of the most significant factors in the market price of utility stocks is the issuing company's annual dividend payout on those shares.

40. TXU's annual dividend per common share was significant to holders of the Securities because the Securities price tracked the common share price, and the common share price to a large degree depended on its dividend yield. Therefore, any potential increase in TXU's common stock dividend was critically important to holders of the Securities.

41. When Wilder was hired in 2004, TXU had since October 2002 paid an annual dividend on its common stock of $0.50 per share.

42. When introduced to the investment community by TXU on February 23, 2004, Wilder told analysts:

> I pledge to you that we will provide investors with detailed disclosures about the key drivers in our business; . . . . As I have said many times to investors, management shouldn't want their company security to be overvalued or undervalued, but fairly valued. And the only way for you to fairly value us is for us to provide you with complete and accurate information. The only exception would be when we think disclosing information will cause us competitive harm and in those cases we will tell you [that].

SEC Form 8k, filed February 23, 2004, Appendix Exhibit "D," at App. Ex. 78.

43. Thereafter, the very first question Wilder was asked by analysts concerned the TXU dividend policy: "John, could you just share with us, we saw comment come on the tape you have used on the dividend policy please?" Wilder responded, in pertinent part:

> The dividend decision of course is a decision for the Board, it's not a decision for management, but from my standpoint as management, I wouldn't be comfortable making a material change in the dividend policy, until I knew all of our businesses were running at high performance levels and I knew we had more than adequate financial flexibility to withstand any market shocks that the company might have. In my way of thinking and with the business portfolio we have our debt would be net debt to total capital in the 40-45 range and strong coverage ratios of 4.0 or greater, I think we can achieve that by '06 and quite frankly there is a possibility we can achieve that by '05.

SEC Form 8k, filed February 23, 2004, Appendix Exhibit "D," at App. Ex. 80.

44. As shown below, cognizant of the significance of the common dividend payout to the convertible Securities that Defendants wanted to eliminate, Defendants more specifically represented that a change in TXU's common share dividend would only be considered in the Third and final Phase of the Three Phase Restructuring Program, not until 2006, and then ***if and only if TXU had already met certain specified financial benchmarks for debt reduction and financial flexibility. Further, as***

shown below, those financial benchmarks had not been met, either at the close of the Tender Offer or at the time of the announcement of the dramatic increase in dividend payouts and share buy-backs. The exact steps TXU took nine days after the close of the Tender Offer were completely inconsistent with the publicly available representations from TXU.

F. TXU's Dividend Policy Statement

45. On May 18, 2004, TXU issued a Press Release ("the May 2004 Press Release"), a true and accurate copy of which is included as Appendix Exhibit "E" at App. Ex. 106. In the May 2004 Press Release, TXU made two key representations regarding its common share dividend payout:

> The first priority for the use of free cash flow will be for investments to preserve and enhance the quality of customer service and production and delivery reliability. The company will then consider reinvestments in its businesses, applying stringent expectations for cash payback timeliness and minimum returns on investment. ***Remaining free cash flow will be used to reduce debt and other liabilities, with the objective of reaching a ratio of total debt to total capitalization below 45 percent and an interest coverage ratio greater than 6 times.*** [hereinafter, the "May Benchmarks"].
>
> ***Upon reaching the targeted balance sheet strength and financial flexibility, management would recommend that the Board of Directors reevaluate the current dividend policy.*** At that time, management expects it would recommend targeting annual common stock dividends equal to a pay out of 100 percent

> of the earnings of TXU's electric delivery business. Of the free cash flow, management would expect to return roughly 80 percent to shareholders in the form of distributions or repurchases and to retain roughly 20 percent for long term growth initiatives. Assuming the execution of the business initiatives and transactions described above, and depending on market trends in commodity prices, ***management expects that this capital allocation program will enable management to recommend an increase of the dividend in 2006.*** In addition to management's recommendation, the Board of Directors may consider other relevant factors in determining if and when to make a change in the dividend policy.

Appendix Exhibit "E," at App. Ex. 111 (emphasis added) ("the Dividend Policy Statement"). According to the Dividend Policy Statement, any increase in the TXU common dividend would be part of Phase Three of Wilder's Restructuring Program, and only expected to occur in 2006 after the May Benchmarks had been met. *Id.* The Dividend Policy Statement was accompanied by Table 3, which illustrated "current expectations of sources and uses of cash for 2004 and 2005," showing ***no change*** in common share dividends for either 2004 or 2005. *Id.*

46. As reflected in the Wilkie Farr letter to TXU, sophisticated investors—who made up the bulk of the market for the Securities at issue in this litigation—were aware of the Dividend Policy Statement, and relied on its accuracy when deciding to sell their Securities to TXU in the Tender Offer.

47. Truthfulness of TXU's Dividend Policy Statement changed significantly before and during the

Tender Offer, without disclosure to Plaintiffs and others who tendered their Securities to TXU. There was ample opportunity for TXU to disclose the subsequent inaccuracy of its Dividend Policy Statement, as both TXU and Wilder chose to speak to the market before and during the Tender Offer concerning that very dividend policy.

48. Indeed, according to the Poole Letter, by August 2004 TXU management had already privately "indicated to the [TXU] Board that, while [its] financial plan at that time did not contemplate a change in the dividend policy for at least 18 months, management was planning to undertake an evaluation of the current dividend in light of current business and market conditions" and had already scheduled a Board meeting in October 2004 to address changing the common share dividend. *See* Appendix Exhibit "B," Poole Letter at App. Ex. 59, 60.

49. Furthermore, according to the Poole Letter, during September 2004 TXU senior management was admittedly working with a "financial advisor" regarding a potential change to TXU's common share dividend. *Id.* at App. Ex. 60.

G. TXU's Stock Repurchase Statement

50. On September 15, 2004, the first day of the Tender Offer, TXU also announced its intent to "repurchase ***up to*** 10 million shares of its common stock, subject to market conditions and other factors" ("the Stock Repurchase Statement") (emphasis added). Appendix Exhibit "F" at App. Ex. 115.

51. Plaintiffs were aware of the Stock Repurchase Statement, and relied on its accuracy in deciding to sell their Securities to TXU in the Tender Offer.

52. As shown below, the truthfulness of the Stock Repurchase Statement changed significantly during the Tender Offer, without disclosure to Plaintiffs and others who sold their Securities to TXU in the Tender Offer.

H. TXU Makes Its Self-Tender Offer for the Securities

53. On September 14, 2004, TXU common stock closed at $44.68 per share, TXU Corporate Units closed at $50.38 per Unit, and TXU PRIDES closed at $48.00 per PRIDES.

54. On September 15, 2004 TXU announced its Tender Offer for up to 11,433,285 outstanding Corporate Units and up to 8,700,000 outstanding PRIDES. TXU filed a Form 8K with the SEC concerning the Tender Offer, a true and accurate copy of which is included as Appendix Exhibit "F" at App. Ex. 115.

55. TXU's Offering Documents relating to its Tender Offer included:

a. TXU Press Release (copy attached as Appendix Exhibit "G" at App. Ex. 125);

b. SEC Schedule TO (copy attached as Appendix Exhibit "H" at App. Ex. 129); and

c. TXU's "Offer to Purchase" (copy attached as Appendix Exhibit "I" at App. Ex. 141).

56. The Tender Offer price for the Corporate Units was determined by applying a factor to the 20-day weighted average price of TXU common stock between September 20, 2004 and October 8, 2004, with a minimum price of $45.97 and maximum price of $52.28 per Corporate Unit. Similarly, the Tender Offer price for the PRIDES was determined by applying a factor to the 20-day weighted average price of TXU

common stock between September 20, 2004 and October 8, 2004, with a minimum price of $46.43 and a maximum price of $52.50 per PRIDES.

57. The Pricing Date for the Tender Offer was set for October 8, 2004, and the offering price for the Securities was announced on October 12, 2004.

58. The Tender Offer expired on October 13, 2004, although TXU "reserve[d] the right, in its sole discretion . . . to extend the time during which either tender offer [remained] open." *See* Appendix Exhibit I at App. Ex. 165.

59. The Offering Documents did not address the Dividend Policy Statement except to state in intentionally vague and identically worded language in TXU's Form 8K, Press Release and Offer to Purchase:

> TXU Corp.'s debt and capital management program is intended to strengthen TXU Corp.'s balance sheet and financial flexibility. As a part of its capital management and restructuring program and considering current business and market conditions, TXU Corp.'s management is evaluating whether it should recommend to the TXU Corp. Board of Directors that they reevaluate TXU Corp.'s current common stock dividend policy. ***TXU Corp. cannot predict the outcome of management's evaluation, when, if at all, management would make a recommendation to the Board of Directors to change the current common stock dividend policy, or what management's recommendation might be.*** In addition to any recommendation from management, the Board of Directors may consider other relevant factors in determining if and when to make a change in TXU Corp.'s common stock dividend policy.

Appendix Exhibit "F," at App. Ex. 120; Appendix Exhibit "G," at App. Ex. 127; Appendix Exhibit "I," at App. Ex. 173 (emphasis added) ("the Dividend Representation"). The Dividend Representation was false because, on September 15, 2004, TXU management was in a position to know when it would recommend a change in TXU's dividend policy to the Board, and in fact knew that such recommendation would be made before 2006, before the May Benchmarks had been met, and before Phase Three of Wilder's Three-Phase Restructuring Program.

60. Nevertheless, the Dividend Representation did not modify the May 2004 Dividend Policy Statement or otherwise disclose that TXU no longer deemed the May Benchmarks necessary or even relevant to a change in its common dividend. Appendix Exhibit "A," Allen Report at App. Ex. 40-41. Nor did the market interpret the Dividend Representation to do so, given the share price response when TXU suddenly increased its common dividend. As shown in the Chart attached as Appendix Exhibit "J" (App. Ex. 178), TXU's representations and omissions had the intended effect of deferring any increase in market price of TXU common stock until the Tender Offer was finished and the convertible Securities had been removed from the market place.

61. As reflected in the Wilkie Farr letter, the sophisticated investors that drove the market for the Securities were aware of the Dividend Representation, and relied on its accuracy and completeness when deciding to tender their Securities. Indeed, the Dividend Representation and subsequent confirmation of the essential benchmarks by Wilder in September—the Wilder Representation addressed below—were specifically identified by the Flaherty &

Crumrine Funds in the Wilkie Farr Letter as evidence of willful misrepresentations to the investing public including Plaintiffs. Appendix Exhibit "C," at App. Ex. 65.

62. TXU's Offering Documents also omit any mention of (a) TXU's intent to make an imminent and dramatic increase in its common share dividend ("the Dividend Omission"), and (b) TXU's intent to make an imminent, dramatic increase in its common stock buyback program ("the Buyback Omission").

63. Plaintiffs were unaware of TXU's Dividend Omission and its Buyback Omission, and relied on Defendants to make a full and truthful disclosure of all material information, so Plaintiffs could make an informed decision to keep or sell their Securities in TXU's Tender Offer.

64. The Dividend Representation, the Dividend Omission and the Buyback Omission were not altered or modified by Defendants at any time during the Tender Offer.

65. On September 20, 2004, the beginning of the Securities Pricing Period, TXU common stock closed at $46.47, TXU Corporate Units closed at $51.50, and TXU PRIDES closed at $50.89.

I. Wilder Reiterates the Near-Term Outlook for No Dividend Increase

66. On September 28, 2004, in the midst of the Tender Offer, Wilder gave a PowerPoint presentation regarding his "Three-Phase Restructuring Program" to investors and securities analysts at the Merrill Lynch "Global Power & Gas Leaders Conference." Aware that it contained information material to investors, on September 28, 2004, TXU incorporated

Wilder's visual presentation into a Form 8-K filed with the SEC, a true and accurate copy of which is attached as Appendix Exhibit "K" (App. Ex. 180).

67. As part of his September 28, 2004 PowerPoint presentation, Wilder presented a screen describing ***Phase Three*** of his TXU restructuring plan: "Capital Allocation." Appendix Exhibit "K," at App. Ex. 219. Wilder in that screen noted TXU's need to "determine our long-term capital allocation policy," including "How much cash we should return to our shareholders?" In that screen Wilder again represented that TXU was only going to use its stated excess cash flow to fund increased dividends and stock repurchases *after* meeting debt-reduction goals ("the Wilder Representation"). Specifically, the Wilder Representation stated that TXU did not intend to fund additional common share dividends and repurchases until: (a) TXU's debtto-market-capitalization ratio came under 50%; (b) TXU's coverage ratio (cash flow to debt service obligations) exceeded 5X; and (c) TXU lowered its attained debt-to-EBITDA to less than 3X (collectively, "the September Benchmarks"). *Id.* Wilder did not modify or abandon the Dividend Policy Statement representation that any change in TXU's common dividend would only come as part of Phase Three of TXU's restructuring program, and should not be expected until 2006. In fact, other than refining one of the May Benchmarks, the content of the Wilder Representation was consistent with the Dividend Policy Statement, dispelling any prospect of an imminent increase in the TXU common dividend.

68. Wilder knew the Securities were held mostly by sophisticated institutional investors, who would follow the May Benchmarks and the September Benchmarks with great interest, to determine whether

to keep or sell the Securities in TXU's Tender Offer, rather than hold and convert the Securities into TXU common stock a mere 50 days later.

69. The Flaherty & Crumrine Funds were aware of the Wilder Representation, and relied on its accuracy and completeness in deciding to sell their Securities to TXU in its Tender Offer. Promptly after TXU surprised Plaintiffs and the market with its dividend increase announcement, the Flaherty & Crumrine Funds retained legal counsel from the law firm of Willkie Farr & Gallagher, LLP, who described their reliance on the Wilder Representation in particular in his ensuing letter to TXU. *See* Appendix Exhibit C (App. Ex. 63).

70. Wilder and TXU knew the Wilder Representation was false and misleading when made. In fact, TXU and Wilder had already taken steps to increase the TXU dividend upon completion of the Tender Offer, without regard to any of the May or September Benchmarks. The Poole Letter admits that by August 2004, TXU management had already begun "informal discussions with a financial advisor to obtain their assistance in evaluating TXU's dividend policy." Appendix Exhibit "B," Poole Letter at App. Ex. 60. And, according to the Poole Letter, by September 15, 2004, TXU management had "undertaken preliminary market and financial analysis regarding dividend policy." *Id.*

71. Furthermore, according to the Poole Letter, by October 12, 2004—during TXU's Tender Offer—TXU "management was in a position to provide the rating agencies a detailed financial plan" providing for a 350% increase in TXU's common share dividend. On October 12, TXU had not met ***any of the May or September Benchmarks***. Thus, during the Tender

Offer, TXU senior management knew they were going to recommend a massive common share dividend increase shortly after the close of the Tender Offer, even though they had repeatedly represented to Plaintiffs and members of the Class that no such recommendation would be made before 2006, before the May and September Benchmarks had been met, or before implementing Phase Three of Wilder's Three-Phase Restructuring Program.

72. TXU and Wilder therefore knew during the Tender Offer that the Dividend Policy Statement, the Dividend Representation, and the Wilder Representation were false and misleading, because a huge dividend increase was imminent without regard to TXU's publicly represented Benchmarks or its other representations regarding timing. TXU and Wilder also knew that, contrary to the Stock Repurchase Statement and the Buyback Omission, a contemporaneous 400% common stock buyback increase was imminent as well. Still, TXU and Wilder did not truthfully disclose this information to the market, or, more importantly, to the investors from whom they were then soliciting the fully-convertible Securities in TXU's Tender Offer. On the contrary, Defendants continued to misrepresent that no change in the dividend or common stock repurchase program was imminent throughout the Tender Offer.

73. As shown below, Defendants' contention, made in the Poole Letter, made to this Court, and made to the Fifth Circuit Court of Appeals, that no one at TXU knew or could have known when TXU management was going to propose an increase in the TXU common dividend until TXU heard from the rating agencies on October 19 and 20, 2004, is simply not plausible. Moreover, it is clearly not as compelling as

the inference, supported by Dr. Allen's Report, that TXU and Wilder knew both before and during the Tender Offer of both (a) the imminence of the planned increases, and (b) the rating agencies' position that those proposed increases would not adversely affect TXU's issuer credit rating.

J. Plaintiffs Tender Their Convertible Securities to TXU.

74. On Friday, October 8, 2004, the end of the Pricing Period, TXU common stock closed at $48.95 per share, TXU Corporate Units closed at $52.20, and TXU PRIDES closed at $52.25.

75. On Monday, October 11, 2004, TXU issued a press release stating the offering price for each Corporate Unit had been fixed at $52.28 and for each PRIDES had been fixed at $52.39, both based upon a $47.89 weighted average price of TXU's common stock during the Pricing Period. A true and accurate copy of this press release is attached as Appendix Exhibit "L" (App. Ex. 236).

76. On Tuesday, October 12, 2004—after announcing the Tender Officer prices and before close of the Tender Offer—TXU management reportedly gave "a detailed financial plan" to Standard & Poor's and Moody's on the effect (or lack thereof) of the dividend increase on TXU's existing debt ratings. Appendix Exhibit "B," Poole Letter at App. Ex. 61.

77. On Tuesday, October 12, 2004, Haiduk accepted TXU's offer to buy his 5,000 Corporate Units at the $52.28 Tender Offer price and 5,000 PRIDES at the $52.39 Tender Offer price.

78. On Wednesday, October 13, 2004, the Flaherty & Crumrine Funds accepted TXU's offer to buy their

425,000 Corporate Units at the $52.28 Tender Offer price.

79. On Wednesday, October 13, 2004, the Tender Offer expired. TXU common stock closed that day at $49.05 per share, the Corporate Units closed at $51.46 per unit and the PRIDES closed at $50.33.

80. On Thursday, October 14, 2004, TXU issued a press release announcing the results of Tender Offer: 7,449,792 Corporate Units (64.6% of outstanding) were tendered, at $52.28 per Corporate Unit; 5,077,362 PRIDES (57.7%) were tendered, at $52.39 per PRIDES. A true and accurate copy of this press release is included as Appendix Exhibit "M" (App. Ex. 239).

K. TXU Announces Its Dividend Payout and Stock Repurchase Increases

81. On Tuesday, October 19, 2004, TXU management gave the TXU Board written materials proposing dramatic increases in the common share dividend payout and the common stock repurchase program. Appendix Exhibit "B," Poole Letter at App. Ex. 61. Significantly, "[t]his material included the financial plan for TXU that was to be presented to analysts and the public on October 25, 2004." *Id.; see also* Appendix Exhibit "N" (a true and correct copy of the News Release announcing the dividend and repurchase increases to the public on October 25, 2004, App. Ex. 241). Thus, according to TXU, the materials were prepared and delivered to the Board ***before*** management had "received feedback from the rating agencies on the materials being reviewed by the rating agencies." Appendix Exhibit "B," Poole Letter at App. Ex. 61.

82. According to the Poole Letter, on Tuesday and Wednesday, October 19 and 20, 2004, TXU for the first time received word from Moody's and S&P that the proposed increase in the dividend would not result in any adverse action by them with respect to TXU's credit ratings. *Id.* Contrary to its later contention, this was not in fact the first indication from the rating agencies that TXU's proposed increases in the dividend payout and stock repurchase program would not adversely affect TXU's credit ratings. Rather, TXU and Wilder were in constant communication with the credit rating agencies before and throughout the Tender Offer. *See* Appendix Exhibit "A," Allen Report at App. Ex. 29; 42. TXU and Wilder therefore knew, during the Tender Offer, that TXU's rating agencies had ***already*** indicated to TXU that the increases would not adversely affect TXU's issuer credit ratings. *Id.*, at App. Ex. 33-34. It is for this reason that, ***before*** receipt of the purported October 19 and 20 credit agency reports, TXU senior management both (a) scheduled the Board meeting to discuss the dividend and repurchase increases and (b) prepared and submitted the dividend announcement materials to the TXU Board.

83. At a Board meeting on Thursday, October 21, 2004, TXU senior management recommended an increase in the annual common share dividend to $2.25 (a 350% increase) and an additional common stock repurchase of 50 million shares (a 400% increase), as set forth in the materials previously prepared and delivered to the Board on October 19, and as subsequently released to the public on October 25, 2004. Exhibit "B," Poole Letter at App. Ex. 61; Appendix Exhibit "N" (App. Ex. 241).

84. At the time the dividend increase was recommended to the Board by TXU senior management, the May Benchmarks of the Dividend Policy Statement ("the objective of achieving a ratio of total debt to total capitalization below 45 percent and an interest coverage ratio greater than 6 times") had not nearly been met. Appendix Exhibit "A," Allen Report at App. Ex. 38.

85. Similarly, at the time the dividend increase was recommended to the Board by TXU senior management the September Benchmarks of the Wilder Representation (a debt-to-market capitalization ratio under 50% and a coverage ratio exceeding 5x; and debt-to-EBITDA of less than 3x) had also not been satisfied. *Id.*

86. Indeed, when TXU senior management recommended the dividend increase to the Board TXU's total debt to capitalization ratio for the first nine months of 2004 was 69.32%, far higher than either the 45% objective stated in the May 2004 Press Release, or the 50% stated in the Wilder Representation and in Wilder's February 23, 2004 introductory analysts' conference call. *Id.* Furthermore, the interest coverage ratio also did not meet the threshold of "greater than 6 times" stated in the May Benchmarks, or the 5x stated in the Wilder Representation. Although the pre-tax interest coverage ratio for the 2004 third quarter (standing alone) was 6.77x, the ratio over the nine months ending September 30, 2004 was only 4.10x—far below the objective of 6x or 5x. The use of the third quarter interest coverage ratio alone would have been extremely misleading for an electrical utility in the South, since earnings (and, therefore, interest coverage ratios) are seasonally in-

flated by the hot summer months' historical high electricity usage.

87. Nevertheless, according to the Poole Letter, on the morning of the next day, Friday, October 22, 2004, the TXU Board approved the dividend and stock repurchase increases. Appendix Exhibit "B," Poole Letter at App. Ex. 61.

88. After the markets closed on Friday, October 22, 2004, TXU filed a Form 8K with the SEC, reporting the dividend increase and disclosing that TXU had "reviewed . . . its revised dividend and cash policies with Fitch Investors Service, Moody's Investor Services and Standard & Poor's," and that "[a]ll three agencies have indicated to [TXU] that they will not be taking any ratings action." A true and accurate copy of the Form 8K is attached as Appendix Exhibit "O" (App. Ex. 248).

L. The Market Reacts and TXU Gloats

89. On Monday, October 25, 2004, TXU issued a press release announcing its "revised dividend and cash distribution policy," increasing its annual common share dividend from $0.50 to $2.25 and revealing its decision to repurchase approximately 50 million additional shares of TXU common stock. *See* Appendix Exhibit "N" (App. Ex. 241)

90. Upon the announced dividend and repurchase increases, TXU common stock on October 25 jumped nearly 20% from $52.81, to close at $61.25 per share (including a record intraday high of $62.40); Corporate Units similarly jumped nearly 10% from $53.35, to close at $57.46 per Unit, and PRIDES likewise increased from $53.25 to close at $55.40 per PRIDES. These increase in market prices occurred on the same day that TXU announced its decision to increase

the common dividend payout and stock repurchase programs.

91. TXU's announcement of the dividend and stock repurchase program increases surprised the market, sending its stock price surging to a then all-time high; one analyst wrote:

> ***TXU Corp. (Bal/BBB) surprised investors with an onslaught of great news, beginning with a 350% hike in its quarterly dividend to $0.5625, or $2.25 annually and a yield of 3.67% based on yesterday's close.***
>
> * * *
>
> ***TXU also specifically stated that it expects a 5% annual dividend growth and that in any given year the board may authorize distributions of up to 75% of the company's operational earnings for that year. The dividend represents a 39% payout ratio for 2005, which is still below the current BBB average of 54%. Nevertheless, the company did more to surprise investors than just hiking its dividend, by announcing a larger common stock repurchase program and raising its EPS estimates substantially for 2004, 2005, and 2006.*** TXU management authorized increasing its share repurchase program from 10 million shares to 50 million shares, which will be on top of the 2 million shares already bought back earlier in the year under the original repurchase program.
>
> * * *

The stock closed up $8.44 to $61.25 a share on Monday, a one day gain of 16%.

Appendix Exhibit "P" (App. Ex. 255) (emphasis in original).

92. The size of the increase in TXU's common share price evidences the market's lack of prior information and disclosure, including any by virtue of the Offering Documents. An information "leakage" study performed by Professor Allen confirms that the market did not have information about the imminent dividend increase or the large stock repurchase before October 25, 2004. Appendix Exhibit "A," Allen Report at App. Ex. 10 fn. 2.

93. On November 16, 2004, one-half of the untendered Corporate Units were converted to common stock trading at $66.05 per Corporate Unit—***more than 25% higher than the Tender Offer price.***

94. On November 22, 2004, TXU effectuated its announced stock repurchase through an agreement with Citibank to buy 52.5 million common shares at $64.57 per share, by close of business November 26, 2004.

95. On November 29, 2004, TXU issued a press release proclaiming completion of Phase One of Wilder's "Three Phase Restructuring Program," which included repurchase of a majority of the Securities, thereby "substantially removing these complicated securities from our balance sheet and avoiding the issuance of as many as 36 million additional shares of TXU Corp. common stock." A true and accurate copy of this press release is Appendix Exhibit "Q" (App. Ex. 257).

96. TXU's increase in its common share dividend and stock repurchase program were not dependent upon completion of the Tender Offer. TXU had arranged ample cash to do all three, through sale of its subsidiaries and bank borrowings.

M. Flaherty & Crumrine Demands an Explanation

97. Understandably feeling duped, on December 13, 2004, the Flaherty & Crumrine Funds asked their outside counsel, Philippe M. Salmon of Willkie Fan, to write to Eric Peterson, TXU's then Executive Vice President and General Counsel. Appendix Exhibit "C" (App. Ex. 63).

98. In the Wilkie Farr Letter, the Flaherty & Crumrine Funds pointed out that TXU was aware of the sensitivity of its stock price to dividend changes, based on the securities fraud action TXU faced in the wake of its October 2002 dividend cut. *Id.* The Wilkie Farr Letter also asserted that the Dividend Representation was materially misleading in that the decision to implement "a substantial increase in the TXU dividend rate did not simply happen spontaneously on October 22, 2004 . . . " and in light of Wilder's Three-Phase Restructuring Program, plans for the dividend increase were "sufficiently formulated and concrete, during the period between September 15 and October 13, 2004, that more specific disclosures were mandated by the federal securities laws." *Id.*, at 64-65.

99. The Wilkie Farr Letter went on to point out TXU's motive to withhold information on the dividend and repurchase increases during the Tender Offer:

> A proper disclosure during the tender offer period of the new dividend program that was finally made public on October 25, 2004 would have resulted in several adverse consequences. Firstly, as noted above, the cost of eliminating the equity-linked, convertible debt securities would be substantially increased by effectively

> raising the anticipated cost of the tender offer. Secondly, equally adverse was the substantial likelihood that many holders would not tender, opting to hold the common stock that would be issued in November, 2004, collecting the increased dividend, and holding the balance of their convertible securities at their appreciated value.

Id. at 65.

100. The Wilkie Farr Letter reiterated the Flaherty & Crumrine Funds' specific reliance on the Dividend Policy Statement, the Dividend Representation, the Wilder Representation and the Dividend Omission.

N. TXU's Phony Explanation[2]

101. On January 18, 2005, then TXU Senior Vice President and Associate General Counsel David P. Poole, responded to the Wilkie Farr Letter on behalf of TXU. Although TXU conceded the significant sensitivity of TXU's common share price to its dividend, and that TXU's decision to significantly increase its dividend did not happen spontaneously on October 22, it denied having made any misrepresentations. Appendix Exhibit "B," Poole Letter at App. Ex. 59-60.

102. Specifically, TXU took the position that "[o]ne critical aspect of [management's] analysis was the impact of changes in dividend policy and capitalization on the credit ratings of debt securities of TXU Corp. and its subsidiaries." *Id.* at 61. TXU insisted

---

[2] Plaintiffs do not accept as true the statements in this Section of the Complaint, but present them to provide the Court with TXU's explanation for its acts and omissions, to facilitate the Court's analysis mandated by *Tellabs v. Makor Issures & Rights, Ltd*, 127 S.Ct. 2399 (2007).

that "[a]bsent feedback from the agencies that a set of proposed changes would not result in a downgrade, management was not in a position to recommend changes in dividend policy to the Board." *Id.* TXU also claimed that "[w]ithout having a response from the rating agencies as to their views on the financial plan, management was not in a position to know what it would recommend to the Board regarding possible changes to the dividend policy." *Id.* The Poole Letter further asserts that management did not provide a "detailed financial plan" to the credit rating agencies until October 12, 2004, and that it received responses from the rating agencies on October 19 and 20, 2004. *Id.*

103. Similarly, on September 6, 2007, legal counsel for TXU and Wilder, in his argument before the Fifth Circuit Court of Appeals, again insisted that nobody at TXU could have "any idea" of the false and misleading nature of the challenged misrepresentations and omissions because TXU management had been "unable to act" until it heard back from the rating agencies after the Tender Offer closed.

104. As confirmed by the Allen Report, the explanation given by TXU is itself false, misleading and completely implausible.

O. TXU's Explanation of *When* It Consulted with Rating Agencies Is Not Credible.

105. TXU did not begin to consult with rating agencies nearly as late as the October 2004 date advanced by Mr. Poole. This tardy timeline and its explanation are not credible. TXU announced the Three-Phase Restructuring Program in early 2004. This Program was a broad restructuring of the Company, including the restructuring of TXU's productive

capacity, strategic plans, marketing and financial structure. For example, the restructuring outlined in the May 2004 Press Release projected $3.36 billion in asset divestitures. Appendix Exhibit E, at App. Ex. 107-114. TXU's SEC Form 10Q filed for the second quarter of 2004 shows total TXU assets of $30.102 billion. The asset divestiture announced in May 2004 represents an 11% decrease in TXU's operating assets base. More than $4 billion of asset sales were completed by TXU during June and July, 2004. Under Mr. Poole's explanation, by the time the credit rating agencies were consulted, more than $4 billion in cash had been raised through TXU asset sales, and the financial restructuring was well underway. It is not credible that TXU would wait until well after these asset divestures were underway, to initiate an issuer credit review. There would have been detailed consultations with credit rating agencies around the time of the May 2004 Press Release, and prior to the start of TXU's restructuring, and certainly before the June and July asset sales were irrevocably closed. In fact, Moody's prepared a detailed analysis of TXU's financial standing, which it released on September 2, 2004. Appendix Exhibit "A", Allen Report at App. Ex. 29; 42.

106. The detailed consultations with credit rating agencies would have encompassed a continuous flow of information between TXU and the rating agencies concerning the entire Three Phase Restructuring Program, only a small component of which would have been a possible increase in the common share dividend. Appendix Exhibit "A," Allen Report at App. Ex. 30.

107. Furthermore, there are two types of credit ratings. One is a credit rating placed on a specific is-

sue of debt. The other is a more generalized issuer credit rating. An issuer credit rating, as described by Moody's, is "a current opinion on an issuer's overall capacity to pay its financial obligations-that is, its fundamental creditworthiness. This opinion focuses on the issuer's ability and willingness to meet its financial commitments on a timely basis. It generally indicates the likelihood of default regarding all financial obligations of the firm . . ." TXU sought from the credit rating agencies input on its issuer credit rating. *Id.* at 30; 35.

108. Examination of broad restructuring by a multi-billion-dollar public utility would take the credit rating agencies far more than the few days represented by Mr. Poole. That examination is a time consuming exercise in forward projection and analytical assessment of the utility's massive business restructuring plan, disparate productive capacity, and its revenue turnover, profitability and capital structure. *Id.* at 17-19.

109. During 2003 and 2004, the three credit rating agencies became much more careful in and issuance review of credit ratings, because the Enron and WorldCom defaults had just taken place, and fingers were being pointed in blame. These companies had enjoyed investment-grade credit ratings shortly before their defaults. Following these defaults, the credit rating agencies became much more careful and strict in their information requirements and analysis on issuer credit ratings. TXU's explanation that it first received input from its credit rating agencies in October 2004 is not at all plausible. *Id.* at 20.

110. TXU's contention that management had to wait for the credit rating agencies to "rule" on the impact of a dividend increase is furthermore not

credible because by the time of the Tender Offer, TXU senior management already *knew* the credit rating agencies would not downgrade its issuer rating based on the common share dividend ***increase*** because the proposed dividend policy would have ***improved*** TXU's performance in several of its deficient financial performance ratios. *Id.* at 34-35; 54.

111. Moreover, the dividend at issue was funded largely out of asset restructuring-specifically cash and savings from the sale of underperforming portions of the Company. Dividends funded by asset restructuring would generally not result in downgrade of a firm's issuer credit rating. *Id.* at 31.

112. TXU knew this because it had admittedly hired its own financial analysts who were well-aware of the financial models run by each of the debt rating agencies, and would have made their own calculations to determine the credit effect of any dividend increase, well before they submitted their detailed financial plan to any of the rating agencies. *Id.* at 26.

113. For all of the above reasons, and as set out in the Allen Report, TXU's explanation for its failure to provide the Tender Offer offerees with earlier disclosures is not credible, was itself false and misleading, and is itself further evidence of *scienter*. Plaintiffs and class members should have been told what TXU was about to do to them.

SCIENTER

114. TXU and Wilder deliberately concealed from recipients of TXU's Tender Offer their intent to materially increase the common share dividend and stock repurchase program immediately upon close of the Tender Offer, which induced Plaintiffs and other holders of the Securities to sell them to TXU at the

Tender Offer price, which in turn eliminated the Securities more cheaply than would this impending scheduled mandatory conversions, and thereby reduced TXU's common stock conversion (and dilution) risk. TXU and Wilder were very aware that by maximizing the number of Securities tendered, and by obtaining tender at the lowest possible price, (a) earnings per share of TXU common stock would be positively affected for the immediate quarter and quarters thereafter, and (b) TXU's common shares would be further concentrated, improving TXU's appeal in a Leveraged Buy-Out.

115. There is no question the Dividend Policy Statement, the Stock Repurchase Statement, the Dividend Representation, the Dividend Omission, the Buyback Omission and the Wilder Representation were not mere errant remarks or omissions. As conceded by the Poole Letter, these statements and omissions were deliberately made, with carefully chosen language that TXU never refuted or altered during the Tender Offer. Thus, the question of scienter is whether the statements were made to those solicited in the Tender Offer recklessly or with knowledge that they were not true or had been rendered untrue by Defendants' own actions. Under *Tellabs*, the inference of scienter must be cogent and at least as likely as any plausible opposing inference. 127 S.Ct. at 2513.

116. The evidence of scienter in this case, as alleged and documented in detail and with particularity above, is both cogent and far more plausible than TXU's contention that the timing of the dividend and share purchase increases was completely in the hands of TXU's credit rating agencies, given:

a. in the Poole Letter, TXU admits that, even before the Tender Offer commenced, TXU scheduled a Board of Directors meeting for just after close of the Tender Offer, to discuss changing TXU's dividend policy; Exhibit "B," Poole Letter at 2 App. Ex. 60;

b. in the Poole Letter, TXU admits that, before ever receiving responses from its credit rating agencies, TXU senior management provided the TXU Board of Directors with the same prepared written materials it later used to publicly announce the common share dividend and repurchase increases; *Id.* at 61;

c. none of the May Benchmarks or the September Benchmarks had been met or even approached when TXU senior management presented its detailed financial plan justifying the dividend increase to the credit rating agencies on October 12;

d. none of the May Benchmarks or the September Benchmarks had been met or even approached when TXU senior management recommended the common share dividend and repurchase increases to the Board of Directors;

e. TXU had been in constant communication with the credit rating agencies throughout the planning and execution of Wilder's Three Phase Restructuring Program;

f. TXU had, in August, retained the services of financial analysts well-versed in the financial models run by the credit rating agencies who would have been able to tell TXU management in advance what the credit rating agencies' responses would be;

g. the plan to dramatically increase TXU's dividend that was concealed by management during the Tender Offer had the effect of improving, rather than harming, TXU's performance in several deficient financial performance ratios;

h. the "leakage study" performed by Professor Allen and the market's actual reaction demonstrates that the dividend and stock repurchase increases were complete surprises; and

i. TXU and its management held all the information regarding the planned dividend and stock repurchase increases, controlled the timing of the Tender Offer in which it was the only buyer of its own securities and which it chose not to extend, controlled the timing of its recommendations to the Board, and by their own admission, deliberately chose to conceal their plans from the market until after the Tender Offer was concluded.

117. The Poole Letter, which falsely suggests that TXU senior management did not know the views of the rating agencies on a proposed increase in the common share dividend or in the stock repurchase program until after closing the Tender Offer, itself constitutes further evidence of scienter.

118. Wilder was a sophisticated financial CEO, whose personal wealth was dependent on TXU's stock price. He knew or was reckless in not knowing that a 350% increase in the dividend paid by TXU common shares, and a 400% increase in the common share repurchase program were recommended for Board approval only days after close of the Tender Offer . . .

especially when those increases were made pursuant to his own "Three Phase Restructuring Program." Wilder in particular had to have known his reiterations that any dividend increase was years away and subject to specific performance triggers was materially false and misleading.

MATERIALITY AND RELIANCE

119. The Dividend Policy Statement, the Stock Repurchase Statement, the Tender Dividend Representation, the Dividend Omission, the Buyback Omission and the Wilder Representation were each and all material to Plaintiffs' decision to sell their Securities to TXU in the Tender Offer.

120. The continued validity of the Dividend Policy Statement and the Stock Repurchase Statement, the facts omitted by the Dividend Omission and the Buyback Omission, and the untruthfulness of the Dividend Representation and Wilder Representation separately and together constitute information that a reasonable holder of the Securities would consider important in deciding whether to tender any Securities to TXU in the Tender Offer. Under the circumstances described above, the misrepresented and omitted facts would have assumed (and as to Plaintiffs did assume) actual significance in the deliberations of the reasonable shareholder, so as to alter the "total mix" of information available.

121. TXU itself acknowledged the materiality of the dividend and stock repurchase increases in its October 25, 2004 press release, stating:

> The increase in the common stock dividend rate and the common stock repurchase program of 50 million shares reflect TXU's confidence in future earnings, cash flow and business prospects and

illustrate its commitment to returning cash flow to shareholders in a sensible manner.

Appendix Exhibit "N," at App. Ex. 246.

122. Plaintiffs relied on the truthfulness and accuracy of TXU's and Wilder's public statements, including the May 2004 Press Release (which included the Dividend Policy Statement) and/or the Wilder Presentation (which included the Wilder Representation), in deciding to tender their Securities to TXU in TXU's Tender Offer. During the Tender Offer, Plaintiffs were ignorant of the Dividend Omission and the Buyback Omission, the subsequent invalidity of the Dividend Policy Statement and Stock Repurchase Statement, and of the misleading nature of the Dividend Representation and Wilder Representation, and believed the Offering Documents to be complete and truthful. Had Flaherty & Crumrine Funds and their investment advisor, and had Haiduk known the truth concerning the imminent and dramatic increase in the TXU common share dividend and repurchase program, never disclosed by Defendants, they would not have sold their Securities to TXU in the Tender Offer.

CLASS ACTION ALLEGATIONS

123. Plaintiffs assert their federal securities law claims on behalf of themselves and on behalf of a Class consisting of all persons who sold the Securities to TXU in the Tender Offer, for damages caused by Defendants' actions. Excluded from the Class are Wilder and TXU.

124. The Class consists of hundreds of sellers of the Securities in the Tender Offer. The identities and addresses of Class members can be readily ascertained from business records maintained by TXU.

125. The claims asserted by Plaintiffs are typical of the claims of the Class.

126. Plaintiffs will fairly and adequately protect the interests of the Class because they have no interest antagonistic to those of the other Class members, and Plaintiffs have retained, as Class Counsel, attorneys who are knowledgeable and experienced in securities matters, as well as class and other complex litigation. The Flaherty & Crumrine Funds have undertaken to pay the substantial costs of this litigation, for the benefit of themselves and all other members of the proposed Class.

127. Plaintiffs request that the Court afford Class members notice and the right to opt-out of any Class certified in this action.

128. This action is appropriate as a class action pursuant to Rule 23(b)(3), Federal Rules of Civil Procedure.

129. Questions of law or fact affecting the Class predominate over those questions affecting only individual members. Those common questions include:

a. whether the Dividend Policy Statement and the Stock Repurchase Statement were rendered false and misleading by TXU internal corporate events occurring before and during the Tender Offer;

b. whether the Dividend Representation was false and misleading when made in TXU's Offering Documents;

c. whether the Dividend Omission and the Buyback Omission made the Offering Documents false and misleading;

d. whether the Wilder Representation was false and misleading when made during the Tender Offer;

e. whether the Dividend Policy Statement, the Stock Repurchase Statement, the Dividend Representation, the Dividend Omission, the Buyback Omission and the Wilder Representation were material;

f. whether each Defendant acted with the requisite degree of scienter;

g. whether each Defendant's actions violated Section 14(e) of the Exchange Act and the regulations promulgated thereunder;

h. whether each Defendant's actions violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder;

i. whether Wilder has controlling person liability under Section 20(a) of the Exchange Act;

j. whether Plaintiffs and members of the Class are entitled to compensatory damages;

k. what is the proper measure of damages recoverable by Plaintiffs and members of the Class;

l. whether Plaintiffs and members of the Class are entitled to an award of punitive damages; and

m. whether Plaintiffs and members of the Class are entitled to such other relief as the Court may deem just and proper.

130. A class action is superior to other available methods for the fair and efficient adjudication of this controversy for at least the following reasons:

a. given the expense of litigating the claims alleged herein, few Class members could obtain cost-effective relief on an individual basis for the wrongs that Defendants committed against them, or would otherwise have a substantial interest in individually controlling the prosecution of an individual action;

b. when Defendants' liability has been adjudicated, claims of all Class members can be determined by the Court;

c. this action will cause an orderly and expeditious administration of the Class claims and foster economies of time, effort and expense, and ensure uniformity of decisions;

d. without a class action, Defendants' violations of law will remain unaddressed, allowing Defendants to reap and retain the substantial proceeds of their wrongful conduct; and

e. this action does not present any undue difficulties that would impede its management by the Court as a class action.

FIRST CAUSE OF ACTION

(Against Defendants under Section 14(e) of the Exchange Act on behalf of Plaintiffs and the Class)

131. Plaintiffs repeat and reallege each and every allegation contained above as if fully set forth herein.

132. Section 14(e) of the Securities Exchange Act as supplemented by the Williams Act of 1968 makes it unlawful:

> . . . for any . . . person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the state-

> ments made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition or in favor of any such offer, request, or invitation.

15 U.S.C. § 78n(e) (2000).

133. As alleged in detail above, in violation of Section 14(e), Defendants made misstatements and omissions of material fact with scienter (the Dividend Policy Statement, the Stock Repurchase Statement, the Dividend Omission, the Buyback Omission, and the Dividend Representation and/or Wilder Representation) in connection with the Tender Offer, which Plaintiffs relied upon in deciding to sell their Securities to their proximate injury.

134. The Supreme Court, in *Piper v. Chris-Craft Indust., Inc.*, 430 U.S. 1 (1977), held that a private right of action is implied under Section 14(e) for the class of securities holders whose securities are sought in a tender offer. The *Piper* Court concluded that "the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer." 430 U.S. at 35. The Court quoted with approval *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975), which stated that "[t]he purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information." 430 U.S. at 35.

SECOND CAUSE OF ACTION

(Against Defendants under Section 10(b) of the Exchange Act on behalf of Plaintiffs and the Class)

135. Plaintiffs repeat and reallege each and every allegation contained above as if fully set forth herein.

136. Section 10(b) of the Exchange Act provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b).

SEC Rule 10b-5, promulgated pursuant to Section 10(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

137. As alleged in detail above, in violation of Section 10(b) and Rule 10b-5 Defendants made misstatements and omissions of material fact with scienter (the Dividend Policy Statement, the Stock Repurchase Statement, the Dividend Omission, the Buyback Omission, and the Dividend Representation and/or Wilder Representation) in connection with TXU's purchase of its Securities in its Tender Offer, which Plaintiffs relied upon to their proximate injury in deciding to selling its Securities.

THIRD CAUSE OF ACTION

(Controlling Person Liability against Wilder on behalf of Plaintiffs and the Class)

138. Plaintiffs repeat and reallege each and every allegation contained above as if fully set forth herein.

139. Wilder violated Section 14(e), Section 10(b) and Rule 10b-5 by his acts and omissions alleged in this Complaint. By virtue of his position as a controlling person of TXU, Wilder is also liable pursuant to Section 20(a) of the Exchange Act.

140. By virtue of his operational and management control of TXU's businesses and his systematic involvement in the fraudulent scheme alleged herein, Wilder had the power to influence and control and did influence and control, directly or indirectly, the decision-making and actions of TXU, including the content and dissemination of the Dividend Policy Statement, the Stock Repurchase Statement, the

Dividend Omission, the Buyback Omission, the Dividend Representation and the Wilder Representation, which Plaintiffs contend were false and misleading.

141. In particular, Wilder had direct and supervisory involvement in the operations of TXU as President and Chief Executive, and, therefore, is presumed to have had, and did exercise, the power to control or influence TXU's conduct in the Tender Offer, leading to the securities violations alleged herein.

FOURTH CAUSE OF ACTION

(Alternative Common Law Fraud against Defendants on behalf of the Individual Plaintiffs)

142. Plaintiffs repeat and reallege each and every allegation contained above as if fully set forth herein.

143. Although common law fraud and federal securities fraud claims share many elements, of the Private Securities Litigation Reform Act requirements that Plaintiffs allege facts giving rise to a strong inference of *scienter* only applies to claims brought under the federal securities laws. *See* 15 U.S.C. § 78u-4 (b)(2). This Court has already determined that Plaintiffs' First Amended Complaint (which contained fewer detailed factual allegations supporting Defendants' *scienter* than does this complaint, and which the Court analyzed prior to the Supreme Court's decision in *Tellabs*) satisfied all of the pleading requirements for a federal securities law claim, other than alleging facts giving rise to a strong inference of *scienter*. *See* Memorandum Opinion and Order of August 30, 2006 (D.E. 33). Such allegations are not required for common law fraud claims under Federal Rule of Civil Procedure 9. *See* Fed. R. Civ. P. 9(b) ("Malice, intent, knowledge and other condition of the mind of a person may be alleged generally.").

144. Thus, in the unlikely event the Court determines this complaint fails to allege facts supporting a strong inference of *scienter* under the analysis mandated by *Tellabs*, and refuses Plaintiffs an opportunity to replead, Plaintiffs alternatively assert these individual claims for common law fraud. Specifically, as alleged in detail above, Defendants made materially false and misleading statements and representations to Plaintiffs (*i.e.*, the Dividend Representation and the Wilder Representation), and/or failed to disclose material facts necessary to make their misrepresentations not misleading (*i.e.*, the Buyback Omission and the Dividend Omission), which Plaintiffs relied upon to their proximate injury in deciding to sell their Securities to TXU.

145. In making such deceptive statements, representations, and omissions, Defendants and their authorized agents and representatives acted knowingly or with reckless disregard for the truth, and with the intention of inducing Plaintiffs to act upon them by tendering their Securities to TXU.

146. Plaintiffs did not know the truth about the statements, representations, and omissions complained of herein. They believed these statements and representations to be true and accurate, and reasonably relied on that truth and accuracy. In reasonable reliance on the statements, representations, and omissions of material fact made by Defendants and their authorized agents and representatives, and in ignorance of the true facts, Plaintiffs were induced to, and did, tender their Securities to TXU for an artificially suppressed price. Had Plaintiffs known the truth, they would never have accepted TXU's Tender Offer.

147. This conduct by Defendants and their authorized agents and representatives was knowing, willful, wanton, malicious, outrageous and done in reckless disregard of Plaintiffs' rights, for which Plaintiffs seek punitive damages.

148. As a direct and proximate result of the foregoing, Plaintiffs have been damaged in an amount to be determined at trial, but which readily exceeds the jurisdictional requirements of this Court.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs on behalf of themselves and of the Class pray for relief and judgment, as follows:

(a) Declaring this action to be a class action pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure, on behalf of the Class defined herein;

(b) Awarding Plaintiffs and the other Class members compensatory damages in an amount to be proven at trial, together with interest thereon;

(c) Awarding Plaintiffs and other Class members pre-judgment and post-judgment interest, as well as their reasonable attorneys' and experts witness fees and other costs;

(d) Awarding such other and further relief as this Court may deem just and proper, including any extraordinary equitable and/or injunctive relief as permitted by law or equity, to attach, impound or otherwise restrict Defendants' assets to assure that Plaintiffs and other Class members have an effective remedy; and

(e) Awarding other and further relief as this Court deems appropriate.

JURY DEMAND

Plaintiffs demand a trial by jury.

DATED: November 26, 2007.

DODGE & ASSOCIATES, P.C.

/s/ David W. Dodge
Michael C. Dodge (TBN 05937000)
E-mail: miked@texasatty.com
David W. Dodge (TBN 24002000)
E-mail: davidd@texasatty.com
Regency Plaza
3710 Rawlins Street, Ste. 1600
Dallas, Texas 75219
Phone: (214) 273-3280
Fax: (214) 273-3281

SHOCKMAN LAW OFFICES, P.C.
Rosemary J. Shockman
E-mail: RShock@aol.com
3001 Camelback Road Suite 120
Phoenix, AZ 85016
Phone: (602) 955-2465
Fax: (602) 955-2613

BONNETT, FAIRBOURN, FRIEDMAN & BALINT, P.C.
Andrew S. Friedman
E-mail: afriedman@bffb.com
Francis J. Balint, Jr.
E-mail: fbalint@bffb.com
2901 N. Central Avenue, Suite 1000
Phoenix, Arizona 85012
Phone: (602) 274-1100
Fax: (602) 274-1199

Samuel Issacharoff (TBN 00785352)
E-mail: si13@nyu.edu
40 Washington Square South
New York, NY 10012
Phone: (212) 998-6580
Attorneys for Lead Plaintiffs

CERTIFICATION OF NAMED PLAINTIFF PURSUANT TO FEDERAL SECURITIES LAWS

Flaherty & Crumrine Preferred Income Fund Incorporated, a Maryland corporation ("Plaintiff") declares the following as to the claims asserted under the federal securities laws, that

1. Plaintiff has reviewed the complaint filed in this matter and has authorized the filing of this complaint. Plaintiff retains Bonnett, Fairbourn, Friedman & Balint, P.C., Shockman Law Offices, P.C. and such co-counsel they deem appropriate to associate with to pursue such action on a contingent fee basis.

2. Plaintiff did not purchase the security that is the subject of this action at the direction of Plaintiffs counsel or in order to participate in this private action.

3. Plaintiff is willing to serve as a lead plaintiff either individually or as part of a group. A lead plaintiff is a representative party who acts on behalf of other class members in directing the action, and whose duties may include testifying at deposition and trial. Plaintiff understands that the litigation is not settled, this is not a claim form, and sharing in any recovery is not dependent upon execution of this Certification.

4. Plaintiffs transactions in the TXU Corp, 8.75% securities that are the subject of this action during the period of March 2003 through and including October 15, 2004, are as follows:

No. of Shares	Stock Symbol/ CUSIP	Buy/ Sell	Trade Date	Price Per Share
15,000	873168504	Buy	3/11/2003	$25.2300
25,000	873168504	Buy	4/16/2003	$28.0650
10,000	873168504	Sell	5/6/2004	$45 4500
30,000	873168504	Tender	10/15/2004	$52.2800

5. During the three years prior to the date of this Certification, Plaintiff has not sought to serve or served as a representative party for the class in any action filed under the federal securities laws except as indicated here.

6. Plaintiff will not accept any payment for serving as a representative party on behalf of the class beyond the Plaintiff's pro rata share of any recovery, or as ordered or approved by the court, including any award for reasonable costs and expenses (including lost wages) directly relating to the representation of the class.

Plaintiff declares under penalty of perjury that the foregoing is true and correct.

Executed this 29th day of August, 2005.

FLAHERTY & CRUMRINE
PREFERRED INCOME
FUND INCORPORATED,
a Maryland corporation

/s/ Donald F. Crumrine
Chairman

CERTIFICATION OF 'NAMED PLAINTIFF PURSUANT TO FEDERAL SECURITIES LAWS

Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated, a Maryland corporation ("Plaintiff") declares the following as to the claims asserted under the federal securities laws, that:

1. Plaintiff has reviewed the complaint filed in this matter and has authorized the filing of this complaint. Plaintiff retains Bonnett; Fairbourn, Friedman & Ballint, P.C., Shockman Law Offices, P.C. and such co-counsel they deem appropriate to associate with to pursue such action on a contingent fee basis.

2. Plaintiff did not purchase the security that is the subject of this action at the direction of Plaintiff's counsel or in order to participate in this private action.

3. Plaintiff is willing to serve as a lead plaintiff either individually or as part of a group. A lead plaintiff is a representative party who acts on behalf of other class members in directing the action, and whose duties may include testifying at deposition and trial. Plaintiff understands that the litigation is not settled, this is not a claim form, and sharing in any recovery is not dependent upon execution of this Certification.

4. Plaintiffs transactions in the TXU Corp, 8.75% securities that are the subject of this action during the period of March 2003 through and including October 15, 2004, are as follows:

No. of Shares	Stock Symbol/ CUSIP	Buy/ Sell	Trade Date	Price Per Share
15,000	873168504	Buy	3/11/2003	$25.2300
25,000	873168504	Buy	4/16/2003	$28.0650
10,000	873168504	Sell	5/6/2004	$45.4500
30,000	873168504	Tender	10/15/2004	$52.2800

5. During the three years prior to the date of this Certification, Plaintiff has not sought to serve or served as a representative party for the class in any action filed under the federal securities laws except as indicated here.

6. Plaintiff will not accept any payment for serving as a representative parry on behalf of the class beyond the Plaintiff's pro rata share of any recovery, or as ordered or approved by the court, including any award for reasonable costs and expenses (including lost wages) directly relating to the representation of the class.

Plaintiff declares under penalty of perjury that the foregoing is true and correct.

Executed this 29th day of August, 2005.

FLAHERTY & CRUMRINE
PREFERRED INCOME
FUND INCORPORATED,
a Maryland corporation

/s/ Donald F. Crumrine
Chairman

CERTIFICATION OF NAMED PLAINTIFF PURSUANT TO FEDERAL SECURITIES LAWS

Flaherty & Crumrine/Claymore Preferred Securities Income Fund Incorporated, a Maryland corporation ("Plaintiff") declares the following as to the claims asserted under the federal securities laws, that:

1. Plaintiff has reviewed the complaint filed in this matter and has authorized the filing of this complaint. Plaintiff retains Bonnett, Fairbourn, Friedman & Balint, P.C., Shockman Law Offices, P.C. and such co-counsel they deem appropriate to associate with to pursue such action on a contingent fee basis.

2. Plaintiff did not purchase the security that is the subject of this action at the direction of Plaintiff's counsel or in order to participate in this private action.

3. Plaintiff is willing to serve as a lead plaintiff either individually or as part of a group. A lead plaintiff is a representative party who acts on behalf of other class members in directing the action, and whose duties may include testifying at deposition and trial. Plaintiff understands that the litigation is not settled, this is not a claim form, and sharing in any recovery is not dependent upon execution of this Certification.

4. Plaintiff's transactions in the TXU Corp, 8.75% securities that are the subject of this action during the period of February 2003 through and including October 15, 2004, are as follows:

No. of Shares	Stock Symbol/ CUSIP	Buy/ Sell	Trade Date	Price Per Share
200,000	873168504	Buy	2/5/2003	$28.1400
20,000	873168504	Buy	3/11/2003	$25.2300
25,000	873168504	Buy	3/12/2003	$25.8660
100,000	873168504	Buy	4/11/2003	$27.5430
100,000	873168504	Buy	4/30/2003	$29.9300
80,000	873168504	Sell	5/6/2004	$45.4500
365,000	873168504	Tender	10/15/2004	$52.2800

5. During the three years prior to the date of this Certification, Plaintiff has not sought to serve or served as a representative party for the class in any action filed under the federal securities laws except as indicated here.

6. Plaintiff will not accept any payment for serving as a representative party on behalf of the class beyond the Plaintiff's pro rata share of any recovery, or as ordered or approved by the court, including any award for reasonable costs and expenses (including lost wages) directly relating to the representation of the class.

Plaintiff declares under penalty of perjury that the foregoing is true and correct.

Executed this 29th day of August, 2005.

FLAHERTY & CRUMRINE
PREFERRED INCOME
FUND INCORPORATED,
a Maryland corporation

/s/ Donald F. Crumrine
Chairman

APPENDIX F

Expert Report
Professor Linda Allen

Flaherty & Crumrine Preferred Income Fund Inc., *et al.*

v.

TXU Corporation and C. John Wilder

November 26, 2007.

Expert Report
Professor Linda Allen

Flaherty & Crumrine Preferred Income Fund Inc., et al.

v.

TXU Corporation and C. John Wilder

November 26, 2007.

Table of Contents

	Page Nos.
I. Executive Summary	2-10
a. Expert Qualifications	10-11
II. Credit Rating Agencies	11-12
a. The Rating Review Process	12-15
b. The Relationship Between Dividend Policy and Credit Ratings	15-17
III. TXU's Dividend Policy	17-21
a. The October 25, 2004 Announcement	21-22
b. The Possible Impact of the Tender Offer on TXU's Ratings	22-25
c. The Possible Impact of Dividend Increases on TXU's Ratings	25-30
d. TXU's Lack of Compliance With Its Stated Objectives	31-33
e. Management Incentives	34
IV. Conclusions	35-37

Exhibit 1 Timeline of Selected Events, May 2004—October 2004
Exhibit 2 Curriculum Vita for Professor Linda Allen
Exhibit 3 Documents Examined
Exhibit 4 Moody's Rating Reviews and Outlooks by Sector

Exhibit 5 Quarterly Dividend Changes in the Utility Industry
Exhibit 6 Relative Equity Impact Standard & Poor's
Exhibit 7 TXU Financial Ratios v. Moody's and S&P Benchmarks for Utilities Notes to Exhibit 7 Definitions of Financial Ratios
Exhibit 8 Impact of Large Rating Increases (100%) on Long-Term Credit Ratings

I. Executive Summary

I have been retained to opine on the sequence of some events that took place during the period from May through October 2004 regarding TXU Corporation's (hereinafter, TXU) conduct in calling for and completing a tender over for convertible securities, and the Company's subsequent 350% increase in common stock dividends, together with a buyback of 50 million shares. On May 18, 2004, TXU management issued a press release which stated (on page 4) that "TXU plans to repurchase over $4 billion of debt, equity, and/or equity-linked securities in 2004..." On September 15, 2004, apparently as part of that multiyear restructuring plan, the Company initiated a tender offer for 11 million shares of its convertible series (TXU 8.75% Series C) and 8.7 million shares of its Income PRIDES (hereinafter, referred to as the tender offer). TXU set the tender offer to expire on October 13, 2004. This tender offer was to initiate a multiyear "comprehensive liability management program geared toward increasing value and reducing risks" (May 2004 press release, page 4) that would include further purchases of "an additional $800 million to $900 million of debt, equity, and/or equity-linked securities in 2005." (May 2004 press release, page 4).

In the May 2004 press release, TXU management also stated that *after* this ambitious multiyear restructuring plan was completed, a dividend policy change would be considered. On page 5 of the May 2004 press release, "Upon reaching the targeted balance sheet strength and financial flexibility, management would recommend that the Board of Directors reevaluate the current dividend policy." TXU management repeatedly asserted that dividend policy changes would take place *after* the completion of the restructuring plan, i.e., in late 2005 or 2006. In a presentation dated May 18, 2004 and again on September 28, 2004, John Wilder projected that debt reductions would be completed in the year 2005 (page 23 of the May 18th presentation) and dividend policy changes would occur only after the debt reduction is completed following a "strict capital allocation philosophy" (page 28 of the May 18th presentation) and a "capital allocation following a rigorous and disciplined process" (page 38 of the September 28th presentation). That is, until the financial objectives were met, TXU would not consider dividend increases.

As I will show in this report, TXU had not met its own stated financial objectives before it announced the dividend increase on October 25, 2004. TXU management repeatedly stated publicly that dividend increases would be considered only *after completion* of a series of restructuring activities projected for the year 2005—that is, TXU's public statements led the market to believe that dividend policy was not scheduled to be reviewed until the year 2005 or later. In the August 2004 10-Q, TXU management communicated that any dividend increase should not be expected until the year 2006, corroborating the May 2004 press release, which stated that "management expects that this capital allocation program will ena-

ble management to recommend an increase of the dividend in 2006." As stated in the August 2004 10-Q:

> "Upon reaching an appropriate level of balance sheet strength and financial flexibility, management expects to recommend that the Board of Directors reevaluate the current common stock dividend policy. At that time, management expects it would recommend targeting annual common stock dividends equal to a payout of 100% of the earnings of Electric Delivery. Of TXU Corp.'s free cash flow (cash provided by operating activities less capital expenditures), management would expect to return approximately 80% to shareholders in the form of distributions or repurchases and retain approximately 20% for long-term growth initiatives. Assuming the execution of the business initiatives and transactions described above, and depending on market trends in commodity prices, management expects that the capital allocation program will enable management to recommend an increase of the TXU Corp. common stock dividend in 2006."

Even the Merrill Lynch presentation by C. John Wilder on September 28, 2004 repeated assertions contained in the May 18, 2004 presentation that a dividend policy change depended on the achievement of specified financial benchmarks, and therefore, was not imminent. The September 2004 presentation focused on a detailed three phase plan for the restructuring of TXU (also described in the May 2004 presentation). Page 6 of the September 2004 presentation states that "Phase 1 Execution is Largely Complete." The only reference to dividend policy is on page 38 ("under review") and it is mentioned in the

context of Phase 3, to be undertaken only after both Phase I and 2 are completed. Indeed, the dividend policy review was not scheduled until the very end of Phase 3 (the next to the last step)—far into the future.[1] Moreover, the tender offer did not state that a dividend increase was under serious review and that an announcement would be imminent. Thus, rational market participants were well justified in their expectation that there was no dividend increase visible on the immediate horizon. Indeed, the May 2004 press release projected no change in dividends for all of 2004 and 2005. The balance of TXU's public statements leading up to the closing of the tender offer reinforced this false and misleading disclosure (for a detailed discussion of the disclosures by TXU management, see Section III D of this report).

However, on October 22, 2004, only nine *calendar days* after the tender offer closed, the TXU Board approved a dividend increase of 350%, along with a 50 million share buyback of TXU common stock. This was announced in a press release on October 25, 2004. The market was stunned by this unexpected announcement.[2] In fact, at 04:08 on October 26, 2004,

---

[1] TXU management never revealed prior to the October 25th announcement that the three phase trigger for dividend increases had been abandoned. Indeed, the press release on October 25, 2004 states that "it will take the balance of 2005 to adequately address Phase Three." (page 2) Thus, the October 25th announcement reflects a material deviation from the time table for a dividend increase scheduled to take place only at the *end* of Phase 3 that was disclosed by John Wilder in his May 18, 2004 and September 28, 2004 presentations.

[2] I performed an event study analysis to ascertain whether there was any leakage of information prior to the October 25, 2004 announcement and found no significant market reaction as long as 11 trading days prior to the announcement date, demon-

the *US Morning Comment* published under Credit Sights, **"TXU Corp. (Bal/BBB-) surprised investors with an onslaught of great news, beginning with a 350% hike in its quarterly dividend to $0.5625, or $2.25 annually . . . Nevertheless, the company did more to surprise investors than Just hiking its dividend, by announcing a larger common stock repurchase program . . . "** (emphasis in the original).

It is my expert opinion that such a dramatic shift in dividend/capital structure policy could not have happened within the short nine day window between the closing of the tender offer and the Board's decision. In terms of book values, the impact of the dividend increase, share repurchase and tender offer was material—decreasing TXU's equity to capitalization ratio (i.e., book value of equity divided by the sum of total debt plus equity book value) from 28.76% in the third quarter of 2004 to only 5% as of the end of the fourth quarter of the 2004.[3] TXU management would have been examining the financial implications of such a dramatic move for weeks, if not months, prior to recommending it to the Board. Despite the fact that they were seriously considering such a substantial policy shift and conducting detailed analysis throughout the tender period in order to prepare for the eventuality of a large dividend increase, TXU did

---

strating that the October 25th announcement took the market completely by surprise. In contrast, the *abnormal return* (daily stock return computed after adjusting for market movements) on the October 25th event date was 15.67%, with a t-statistic of 9.024, which is statistically significant at the 1% level. Thus, the dividend increase was highly beneficial to stockholders.

[3] In terms of the market value of equity, the equity to total capitalization ratio increased from 54% to 55%.

not reveal any of this important information to the public. In particular, participants in the tender offer should have been informed about this material development. That is, TXU management should have informed the market that a substantial dividend increase was under serious consideration, even if the exact terms of the dividend policy change were not yet finalized.

In a letter dated January 18, 2005, Mr. David Poole represented TXU's account of the events surrounding the dividend policy change. That is, in his letter dated January 18, 2005, Mr. David Poole, representing TXU, stated by way of an explanation of the process leading to the dividend increase:

> One critical aspect of this analysis [leading to management recommendations to the Board] was the impact of changes in dividend policy and capitalization on the credit ratings of debt securities or TXU Corp. and its subsidiaries. To assist in this evaluation, TXU Corp. engaged Moody's and Standard & Poor's to provide a ratings advisory service with respect to the impact on the ratings of these possible changes. Absent feedback from the agencies that a set of proposed changes would not result in a downgrade, management was not in a position to recommend changes in dividend policy to the Board. (page 3, Poole Letter).

In particular, Mr. Poole admitted that, in August 2004, management began "informal discussions with a financial advisor to obtain their assistance in evaluating TXU's dividend policy." (Page 2 of the January 2005 Poole letter). Moreover, he admitted that on September 15, 2004, "TXU management had only undertaken preliminary market and financial analy-

sis regarding dividend policy . . . " (page 2 of the January 2005 Poole letter). On page 3 of the letter, Mr, Poole stated that, "It was not until October 12, 2004 that management was in a position to provide the rating agencies a detailed financial plan . . ." Thus, by Mr. Poole's own admission, management had completed its analysis sometime during the period from September 15 through October 12, 2004—*before the closing of the tender offer.* It was at that point in time—prior to the closing of the tender offer—that management was responsible for a full release of all information regarding the likelihood of a dividend increase. Moreover, if TXU's management warned to release a definitive decision to the public, they could have and should have extended the closing date for the tender offer.[4]

However, the entire timeline presented by Mr. Poole and TXU management is not at all plausible. The proposed plan outlined by John Wilder in his September 28, 2004 presentation (as well as an earlier presentation on May 18, 2004) represents a broad restructuring of TXU's productive capacity, strategic plans, marketing and financial structure. It is inconceivable that the Company would have undertaken such a broad restructuring plan without detailed financial analysis, including a comprehensive review by the credit rating agencies. The input of the credit rating agencies in opining on the *entire restructuring plan* is critical because TXU was only marginally

---

[4] Page 19 of the tender offer states. "TXU Corp. reserves the right, in its sole discretion, at any time and from time to time, to extend the period of time during which either [tender] offer is open . . . "

investment grade, with a BBB-/Bal credit rating.[5] A single notch decline would have jeopardized TXU's investment grade status, with disastrous effects on the Company in general, and on the prospective energy trading division in particular.[6] As will be described in Section II of this report, credit rating agencies do not simply examine narrow financial measures of the companies that they rate. Instead, they conduct comprehensive reviews of the firm's business—including productive capacity, profitability, marketing capability, business strategy, as well as financial strength—in order to assess a firm's creditworthiness. *This would most certainly have been done at the start of the restructurings plan, not midway through its implementation.* The timeline presented in Exhibit 1 shows that, according to Mr. Poole's account, by the time that the credit rating agencies were consulted, more than $4 billion in cash had been raised through asset sales, and the finan-

---

[5] Credit ratings range from AAA/Aaa to D/C with the BBB-/Baa3 rating representing the lowest investment grade rating. A drop of even one notch, therefore, would have classified TXU as below investment grade, i.e., junk status. In fact, Moody's rated TXU Corp. as below investment grade (Ba1). whereas S&P gave the Company its lowest investment grade rating (BBB-). Credit ratings will be described in more detail In Section 11 of this report.

[6] The May 2004 press release announced that TXU and Credit Suisse First Boston had "entered into a memorandum of understanding to work together on a 50/50 investment in an equity that would become the exclusive energy marketing and trading vehicle for both parties in North America." Page 3. Indeed, companies such as Enron went to great lengths to maintain an (undeserved, in the case of Enron) investment-grade credit rating agency in order to preserve the viability of their energy trading business. On September 29, 2004, TXU announced that this joint venture had not gone forward.

cial restructuring was already well underway with the virtual completion of the hybrid tender offer. In my opinion, it is not plausible that TXU would have waited until this late date to initiate a credit agency review.

The May 2004 press release projects, among other things, a $3.36 billion asset divestiture. Using 10-Q filings for the second quarter of 2004, the total assets of TXU were $30.102 billion as of quarter-end. The divestiture of operating assets projected in the May 2004 press release, therefore, represents more than an 11% decline in TXU's operating base. It is inconceivable that TXU management did not obtain credit rating guidance before initiating such a drastic operating asset liquidation plan. Thus, it is my expert opinion that the credit rating agencies would have been consulted far earlier than the October 12th date presented by Mr. Poole and TXU management. Instead, there should have been detailed consultations around the time of the May 2004 press release and prior to the start of the Company's restructuring. I am of the opinion, therefore, that the credit rating agency review could not have begun as late as October 12, 2004, as contended by Mr. Poole and TXU management. Indeed, Moody's website shows a Moody's analysis of TXU on September 2, 2004 and a Financial Reporting Assessment on September 30, 2004, refuting Mr. Poole's version of the timeline of events.

TXU management's contention, according to Mr. Poole, is that it was the possibility of a dividend increase that triggered the need to obtain guidance from the credit rating agencies, and it was the uncertainty surrounding the rating agencies' ruling about the impact on the Company's ratings that held up the

release of information about the impending dividend increase. As noted above, it is my opinion that TXU's management would have been consulting credit rating agencies for guidance about the impact of the entire restructuring plan on credit ratings, and not for just for one component of the plan—the dividend increase. Moreover, it is my opinion that the data and evidence show that TXU management would have been aware that the rating agencies would rule favorably *on the narrow issue of a dividend increase alone.* That is, the dividend increase would likely reduce a deficiency in which TXU was below the rating agencies' benchmark for BBB-rated electrical utility companies—the common stock dividend payout ratio. Given TXU's precarious financial condition (relative to its peers according to rating agency financial ratio medians), the Company's investment-grade credit rating was more in jeopardy from the asset and equity liquidation policies (e.g., the asset sales and the tender offer) than from the dividend increase. Thus, prudent behavior would have required TXU's management to seek credit rating agency guidance before the start of the asset restructuring program.

Finally, I examine the credit rating process in this report. The major rating agencies—Standard & Poor's (hereinafter, S&P) and Moody's—undertake detailed financial quantitative and qualitative analysis of the companies in preparing issuer credit ratings (i.e., ratings of the entire company's creditworthiness, not just limited to a specific bond or debt issue). This is a time-consuming process. In my expert opinion, this would have taken far longer than the seven *calendar* days represented by Mr. Poole as the period between the October 12th provision of detailed financial analysis to the rating agencies and their decisions on October 19th and 20th.

The report proceeds as follows. The credit rating process is described in Section II. Section III explains TXU's and other companies' dividend policies and the report concludes in Section IV.

A. Expert Qualifications

I have published extensively in the fields of security valuation, credit risk analysis and damages in securities fraud litigation. I am currently the Presidential Professor of Finance at Baruch College Zicklin School of Business, City University of New York. I have been a member of the Standard & Poor's Academic Council since its formation in 2004. The Council consists of ten academics from around the country, invited to advise and consult with S&P managers and analysts at regularly scheduled meetings.

I also have a US patent pending on a new damages calculation model that uses publicly available data and meets Supreme Court *Daubert* standards for expert witness analysis. This model, denoted the Theoretically-Grounded Microstructure Trading Model uses well-established market microstructure literature in order to construct a trading model that is estimated using objective data.[7] My book, entitled *Credit Risk Measurement. New Approaches to Value at Risk and Other Paradigms,* by Anthony Saunders and Linda Allen, Second Edition, John Wiley and Sons, 2002, describes modern methods of loan valuation that evaluate loans as options, uses intensity-based models to decompose the credit spread and

---

[7] L. Allen, "A New Theoretically-Grounded Microstructure Trading Model For Calculating Damages in Shareholder Class Action Litigation," *Stanford Journal of Law, Business and Finance*, vol. 12, no. 1, Autumn 2006, pp. 61-83.

incorporate value at risk techniques. In my most recent book, *Understanding Markel, Credit and Operational Risk, The Value at Risk Approach,* by Linda Allen, Jacob Boudoukh and Anthony Saunders, Blackwell Publishing, 2004, I incorporate all sources of risk (interest rate risk, exchange rate risk, operational risk, as well as credit risk) into the valuation model. My numerous papers published in academic journals cover a myriad of topics including event study analysis, security valuation and its impact on the structure, regulation and management of financial institutions. Moreover, I have consulted for the Central Bank of Israel, in the banking studies department, and have taught executive training courses on risk measurement and management at Lehman Brothers, Cantor Fitzgerald, Bank Leumi, the New York Institute of Finance, as well as at academic institutions such as NYU Stern School of Business, Rotterdam School of Business, Hebrew University School of Business, Bar Ilan School of Business, and Duke University Corporate Education. My *curriculum vita* is attached as Exhibit 2.

My hourly rate is $600. In forming my opinions, I have examined the documents listed in Exhibit 3. I reserve the right to modify my opinions should additional data or documents come to my attention.

II. The Credit Rating Agencies

Credit rating agencies date back to the early twentieth century, with the introduction of Moody's ratings in 1909. This was followed by Poor's Publishing Company in 1916, the Standard Statistics Company in 1922, and the Fitch Publishing Company in 1924.[8]

---

[8] White, L., "An Analysis of the Credit Rating Industry," in *Credit Rene: Methodologies Rationale and Default & Risk,*

In 1975, the SEC designated Moody's, Standard & Poor's and Fitch as "nationally recognized statistical rating organizations" (NRSROs). To this day, these three agencies dominate the market for independent assessment of credit risk. The proposed introduction of the Basel II international bank capital requirements (scheduled for implementation around the world in 2008-2010) assigns NRSROs a new function in the form of the standardized model in which credit ratings are used to assess capital requirements for less sophisticated hanks throughout the world.

A. The Rating Review Process

Although all the rating agencies offer opinions about creditworthiness, there are subtle, but significant differences across agencies. In particular, S&P states that "rating definitions are expressed in terms of default risk,"[9] whereas Moody's states that its "ratings are statements about expected loss."[10] The distinction is critical. S&P focuses on estimates of the probability of default, whereas Moody's considers the ultimate recovery—i.e., the loss given default.[11] Thus, Moody's does not have a default rating, "D," but S&P does.

There are many variables that are used by the credit rating agencies to ascertain default probability and expected losses. As noted by Moody's, "Thorough

---

Michael Ong, editor, Risk Books, New York: 2002, pp. 85-102, page 87.

[9] S&P website: www.standardandpoors.com.

[10] Hamilton, DT, R, Cantor and S. Ou, "Default and Recovery Rates of Corporate Bond Issuers," Moody's Special Comment, February 2002.

[11] Moody's considers expected losses, which can be calculated as the probability of default times the loss given default.

credit analysis is not something that lends itself well to a formulaic approach. Indeed, Moody's considers each issuer on its unique, individual merits considering a host of quantitative and judgmental factors . . . . While historical financial and operating performance is considered, the final rating decision is driven largely by the rating committee's assessment of the issuer's likely future performance. This is embodied in projections—and related financial ratios—intended to predict an issuer's cash flow generation under a number of scenarios, as compared to expected demands on that cash flow. This assessment is largely predicated on a host of qualitative or judgmental factors . . . . "[12] Further, S&P states, "a rating is, in the end, an opinion. The rating experience is as much an art as it is a science."[13]

These quotes demonstrate that the ratings process is not simple, but rather is a time consuming exercise in forward projection and analytical assessment of a company's business plan, productive capacity, turnover, profitability and capital structure. As noted by Cantor and Packer, "The process of obtaining a rating can be lengthy, requiring significant time and effort . . . ",[14] especially for a company as large as TXU with approximately $30 billion in assets. Even if the rating agency has had prior *experience* with a client, newly issued credit ratings (or credit rating

---

[12] Moody's Special Comment. "Financial Ratio Medians for Global Investment Grade Corporates," page 6, January 2001.

[13] S&P Corporate Ratings Criteria, 2002, p. 1.

[14] R. Cantor and F. Packer, "The Credit Rating Industry," *Federal Reserve Bank of New York Quarterly Review*, Summer/Fall 1994, pp. 1-25, page 3, http://findarticles.com/p/articles/mi_m4131/is_n2_v19/al_15943513

reviews) require that the company must be reevaluated with an eye to the future, thereby making past analysis and assessments only the starting point for additional detailed analysis. Moreover, there is a distinction between the rating granted to an issue (a specific debt obligation) and an issuer (the entire corporate entity). The issuer credit rating, which is of relevance in this case, "is a current opinion on an issuer's overall capacity to pay its financial obligations that is, its fundamental creditworthiness. This opinion focuses on the issuer's ability and willingness to meet its financial commitments on a timely basis. It generally indicates the likelihood of default regarding all financial obligations of the firm, since companies that default on one debt type or file under the Bankruptcy Code virtually always stop payment on all debt types."[15] Thus, producing an issuer credit rating (as was requested of the rating agencies in this case) is much more involved and time consuming than an issue credit rating. This is particularly true for a large firm such as TXU with many complex debt and hybrid securities in its capital structure. It is my opinion that Moody's and S&P could not realistically conduct the time consuming and extensive analysis required to arrive at an issuer credit rating review—such as was obtained by TXU in October 2004—after just one week's worth of analysis.

It should also be noted that the time period during which these events took place occurred shortly after Enron and WorldCom's defaults, and after the passage of the Sarbanes-Oxley Act of 2002 that set out new stringent corporate governance requirements for Boards of Directors. Enron and WorldCom were

---

[15] S&P Corporate Ratings Criteria, 2002, page 61.

extremely embarrassing episodes for the credit rating agencies, who were granting these companies investment-grade ratings just shortly prior to their defaults. Thus, during 2003-2004, the credit rating agencies were even more careful in their issuance of credit ratings. They would have been particularly careful in evaluating companies with only marginally investment grade credit ratings. Moreover, TXU was planning to enter into the energy trading arena, a business that left bad memories for rating agencies due to the Enron debacle. Exhibit 4 shows that, as of October 2004, Moody's was conducting overwhelmingly negative rating actions, reviews and outlooks in the utilities industry. Moreover, only 55% of Moody's Ba1-rated firms (out of a total of 173 companies) had stable outlooks, with the remainder under review.[16]

Therefore, it is my expert opinion that S&P and Moody's would not have allowed themselves to be pressured into issuing a hasty and ill-considered rating. They would have insisted on sufficient time and information in order to conduct a full credit review before assessing *the impact* of a dividend increase on the creditworthiness of TXU. Moreover, they would have insisted on a review of the entire restructuring plan, not just the dividend increase.

B. The Relationship Between Dividend Policy and Credit Ratings

Equity in a firm's capital structure represents permanent capital and therefore, all else being equal, will improve the company's creditworthiness and

---

[16] P. Varma, R. Cantor and D. Hamilton, "Moody's Rating Actions, Reviews and Outlooks: Quarterly Update October 2004," *Special Comment*, Figure 5, p. 4.

credit rating. There are several reasons for this. First, equity obligations cannot trigger default. Common stock dividend payments are made only if the firm has sufficient net income and the granting of dividends is entirely under the discretion of management. Although firms are reluctant to reduce their dividends upon entering periods of financial distress, the reduction or elimination of a common stock dividend payment cannot trigger default (although the stock price will generally react very negatively). Second, common stock has no maturity and no repayment obligations.[17] Thus, the firm can issue equity to raise funds for investment and is under no obligation to pay it back, except in the form of dividends if the projects undertaken are successful and the company's earnings increase. Third, equity is a cushion in the event of default. Since equityholders are residual claimants on the firm's assets, the first claim goes to creditors, thereby increasing the likelihood that they will receive payment. Thus, all else being equal, the more equity (in terms of both book value and market value) in a firm's capital structure, the higher its credit rating. For example, an options-theoretic model of credit worthiness, the KMV Moody's model, relates a lower probability of default (higher credit rating) to higher market capitalization (i.e., stock price times the number of shares outstanding).[18]

---

[17] Preferred stock may have a maturity and repayment obligations.

[18] For a discussion of the KMV Moody's model, see chapter 4 of A. Saunders and L. Allen, *Credit Risk Measurement: New Approaches in Value at Risk and Other Paradigms*, Second edition, New York: John Wiley and Sons, 2002. For further discus-

Equity holders receive their payouts out of the firm's net income in the form of dividends and/or capital gains (fueled by retained earnings, or net income (profits) that are reinvested in the firm). Dividend policy is determined by the top management of a firm. Management is reluctant to set a dividend policy that is not sustainable over the long run because declines in dividend payouts send a negative signal to equity markets, thereby causing decreases in stock prices. Indeed, there is a long and well-established academic literature that shows the use of dividend policy as a signaling device by management, such that increases in dividends signal positive performance prospects and thus lead to stock price increases.[19] Thus, the dividend payout ratio is management's signal to the market as to their expectation of the permanent level of asset growth and net income that will be sustainable in the future and, thus, can be safely redistributed to shareholders. Managers prefer a smooth dividend stream to volatility—either up or down—in the dividend payout ratio.

Because of concerns about sustainability, large dividend increases are almost as rare as large dividend decreases. Most often dividend payouts remain the same quarter to quarter. This is particularly true for utilities, which are mature industries with dividend payouts that represent a substantial portion of the return to equity holders.

Exhibit 5 examines the percentage change of quarterly dividend payouts for utility companies (SIC

---

sion of the link between equity values and credit ratings, see Section III B of this report.

[19] For example, see P. Komar, "Shareholder-Manager Conflict and the Information Content of Dividends," *Review of Financial Studies*, vol. 1, no. 2, Summer 1988, pp. 111-136.

code 49). Using S&P's Compustat database, I examine 2,984 quarterly dividend announcements from 2000—2006. The exhibit shows that over the seven year period from 2000—2006, the average percentage dividend change, up or down, is far below the 350% TXU dividend increase announced on October 25, 2004. Indeed, out of the total sample, there were only five instances of dividend increases of 350% or more during the entire seven year period.[20] Such a large dividend increase as TXU's 350% dividend increase would have been carefully considered by management over a considerable length of time so as to determine the impact on the company's viability, as well as the sustainability of such a large increase in TXU's dividend payout ratio. It is my opinion that such a drastic policy decision could not have been planned and implemented within one week's time period and without substantial interaction between the Company and the rating agencies.

III. TXU's Dividend Policy

On October 25th, TXU announced an increase in the annual common stock dividends from $0.50 to $2.25, an increase of $1.75 per share, or a 350% increase in the dividend payout ratio. Even after the 50 million share repurchase, TXU had approximately 239 million shares of common stock outstanding as of the end of the year 2004 (source: S&P Compustat).[21] Therefore, the dividend *increase* would have required an increased annual cash dividend payout of almost $420 million (that is, $1.75 times 239 million),

---

[20] There were no cases of dividend decreases of more than 350%.

[21] The dividend record data was December 3, 2004, and the payout date was January 3, 2005.

representing more than two thirds of TXU's cash and short-term investments as of the end of the third quarter of 2004. The source of the cash required for such an extraordinarily large dividend increase is an important component to be used in analyzing the impact of this important policy change. If the dividend increase was funded out of free cash flow (defined to be operating cash flows minus capital expenditures on plant and equipment, known as capex), the impact could be considered quite positive by both bondholders and stockholders.[22] This is because the payout of a large pool of unencumbered resources removes the potential for misuse of these free cash flows on projects that might benefit managers at the expense of either shareholders or creditors.

In a September 15, 2004 press release announcing the tender offer, mention is made that "TXU Corp. may repurchase up to an additional 10 million shares of its common stock, subject to market conditions and other factors. TXU Corp. has used, and expects to continue to use, proceeds from asset sales, cash from operations and short-term borrowings (which TXU Corp. has repaid, or intends to repay, with proceeds from asset sales and/or cash from operations) to fund these repurchases." (page 2) Indeed, after the dividend payout, TXU's cash and short-term investments decreased from $621 million as of the end of the third quarter 2004 to $155 million as of the end of the fourth quarter 2004 (source: S&P Compustat), suggesting that cash on hand was used to pay for a large proportion of the dividend increase. In large part, the source of the cash used to pay the huge dividend

---

[22] This is particularly true if a large dividend increase signals attractive future growth potential for the firm.

increase was obtained from the proceeds from the sale of assets.[23]

In July 2004, TXU Australia was sold to "Singapore Power, Ltd. for $1.9 billion in cash and $1.7 billion in assumed debt. TXU Australia's operations consisted of a portfolio of competitive and regulated businesses, principally in Victoria and South Australia. TXU Australia's results in 2004 included an after-tax gain on sale of the business of $241 million." (page A-79, 2005 Annual Report of TXU). In a May 18, 2004 presentation, Kirk Oliver stated that the sale of TXU Australia "unlocks trapped capital and reduces FX exposure." (page 149). Thus, TXU sold a profitable business at an attractive price in order to fund part of the dividend increase.

In addition, TXU's gas transmission subsidiary, TXU Fuel, was sold to Energy Transfer Partners, LP for $500 million in cash in June 2004. (page A-8, 2004 Annual Report of TXU). In his May 18, 2004 presentation, Kirk Oliver stated that this sale "unlocks value through more efficient ownership." (page 150). Another asset sale occurred on October 1, 2004, when Atmos Energy merged with TXU Gas, providing TXU with $1.9 billion in cash. Moreover, since TXU Gas was largely a regulated business, having lost $282 million in 2004 (page A-79, 2005 Annual Report of TXU), TXU benefited from the sale of this unprofitable asset, although it took a $193 million after-tax charge. Kirk Oliver referred to the

---

[23] According to TXU's 8K filing dated November 22, 2004, TXU agreed to repurchase 52.5 million shares of its outstanding common stock from Citigroup at a price of $64.57 per share, for a total cost of almost $3.4 billion to be funded "from the proceeds of the anticipated closing of an offering of its debt securities."

prospect of selling TXU Gas in his May 18, 2004 presentation saying that the prospect "improves TXU's portfolio returns and reduces risk." (page 151). Thus, TXU sold an unprofitable division in order to partly fund the dividend increase.

In the May 2004 press release, management publicly stated that $3.36 billion in assets were expected to be sold in 2004. This was presented as one of the conditions to be fulfilled prior to the consideration of a dividend policy change. Footnote 5 of the May 2004 press release states that the $3.36 billion figure does not include $2.15 billion of debt to be assumed by counterparties. The cash proceeds from the three 2004 divestitures (acquired by Singapore Power ($1.9 billion), Energy Transfer Partners ($0.5 billion) and Atmos Energy ($1.9 billion)) totaled $4.3 billion. The Atmos acquisition was announced on October 1, 2004. Added to the earlier asset sales, the Atmos acquisition was enough to put the sum of all asset sales over the $3.36 billion target amount disclosed in May 2004 as a condition for consideration of a dividend increase. If this was the final divestiture required as a condition to the consideration of a dividend policy change, then TXU's management would have known several weeks prior to the closing of the tender offer that a dividend policy change was imminent and that they were accelerating the dividend policy change (ostensibly because of the completion of their expected asset divestitures scheduled for 2004). Since they had apparently decided to ignore their other conditions for the dividend policy change (e.g., the rest of the three phase balance sheet restructuring projected to be completed in 2005-2006), it was incumbent upon TXU management to release this material information to the public at that time, *i.e.*,

October 1. 2004—two weeks prior to the closing of the tender offer. They did not do so.

TXU's management's explanation that they were waiting for the response of rating agencies regarding the dividend increase is further undermined by the recognition that TXU's asset and equity liquidation policies could have had a detrimental impact on TXU's credit ratings. If TXU's management wanted rating agency guidance, then the time to request that service was prior to implementation of the substantial asset and capitalization restructuring plans introduced during the spring of 2004. Instead, according to the Poole account, TXU delayed consultation with the rating agencies until the bulk of the asset and equity liquidations had already been completed. Moreover, the increase in TXU's stock price resulting from a large dividend increase would increase the market value of TXU's equity, which would improve its credit rating, all else being equal. Thus, TXU management's contention that they were concerned about the reaction of the rating agencies to a large dividend increase, but not to the large asset and equity liquidations, is not consistent with financial reality.

A. The October 25, 2004 Announcement

There were two components to the surprise October 25th announcement: (1) a 350% dividend increase and (2) a 50 million share common stock repurchase. There was no hint that TXU management was even considering a 50 million share buyback of common stock before that date.[24] This substantial change in

---

[24] Stock repurchases are discussed in public documents disclosed between May-October 2004 as: (1) a possible share repurchase of *10 million shares or less* mentioned in the September

capital structure should have been analyzed for weeks and months prior to the announcement of the decision. Most importantly, the share repurchase, together with the tender offer, had potentially dangerous implications for the Company's ability to maintain its investment grade credit rating since both actions reduced TXU's equity. For instance, TXU's equity to total capitalization (i.e., book value of equity divided by the sum of total debt plus equity book value) declined from 28.76% in the third quarter of 2004 to only 5% as of the end of the fourth quarter of 2004, conceivably jeopardizing TXU's marginally investment grade credit rating. Thus, TXU would have undoubtedly been consulting the rating agencies, throughout the restructuring process, regarding their review of the implications of the tender offer and the share repurchase on TXU's credit rating. During the entire period of its own internal analysis and its consultation with rating agencies, TXU management did not publicly release a clear statement of their consideration of a possible repurchase of more than 10 million shares of common stock. In my opinion, this represents a failure to disclose material information. Moreover, the vague and inadequate disclosures that were made were misleading.

TXU management also engaged in false and misleading disclosure of information regarding the dividend increase. As evidenced by the granting of a

---

15, 2004 press release—"TXU Corp. may purchase up to 10 million shares of its common stock," (page 2) and (2) the use of share repurchases as one possible method for achieving the target dividend payout ratio of 80 percent mentioned in the May 18, 2004 press release. The actual share repurchase was 400% higher than the limit placed on possible share repurchases disclosed in the September 15, 2004 press release.

dividend increase despite TXU's failure to meet management's own stated benchmarks, the conditions for the consideration of a dividend policy change mentioned in the May and September 2004 presentations were changed at some point in time prior to the October 22nd Board meeting, but management did not update market participants and announce the change in its policy. To the extent that I have been asked to opine on TXU management's false and misleading statements regarding TXU's dividend policy, I will concentrate on the 350% dividend increase, not the share repurchase, in the next sections.

B. The Possible Impact of the Tender Over on TXU's Ratings

In recent years, financial markets have developed hybrid and complex financial securities that have certain debt-like and certain equity-like features. The more equity features, the more equity-like financing received by the firm, and the better its credit rating, all else being equal. The more debt-like features, the higher is the leverage undertaken by the firm and the lower the credit rating, all else being equal [25] Exhibit 6 shows an illustration of certain hybrid securities and S&P's guidance as to their degree of "equity-ness." The more "equity impact" a financial security has, the closer it is to 100% common stock, and the larger is its contribution to an improvement in the company's credit rating. Thus, hybrid securi-

---

[25] Debt financing has tax advantages because interest payments are tax deductible to the firm, whereas dividend payments are not. Thus, a standard theory of corporate capital structure entails a tradeoff between the tax deductibility of debt (advantages of issuing debt) as compared to the risk exposure associated with leverage (disadvantages of issuing debt) to solve for the firm's optimal capital structure mix of debt and equity.

ties that are more likely to convert to equity (such as convertible debt, with mandatory conversion provisions) are more likely to behave like common stock and are therefore considered to be less debt-like and more equity-like by rating agencies—*i.e.*, they have a high degree of "equity impact" that improves credit ratings, all else being equal.

TXU had an assortment of hybrid instruments that had high degrees of "equity impact." Indeed, the securities under the tender offer had mandatory equity conversion features with very short (approximately one year or less) time horizons—placing them around 80% of common equity on the scale shown in Exhibit 6. Thus, if these securities had not been tendered, there would have been considerably more equity in TXU's capital structure. This impact of the tender of TXU's hybrid securities would, therefore, have been to undermine TXU's credit rating, all else being equal. Offsetting this detrimental effect of the tender offer, however, is the reduction of TXU's interest obligations on the hybrid securities during the short time period prior to their conversion into equity. The reduction in interest expenses would, all else being equal, improve the Company's creditworthiness by increasing its interest coverage ratios.[26] Presumably TXU's management had investigated the net effects of the tender offer on the Company's credit

---

[26] Interest coverage ratios are the ratio between earnings and interest expenses. For example, the EBITDA/interest coverage ratio calculates Earnings Before Interest Taxes, Depreciation and Amortization (EBITDA) divided by interest expenses. EBITDA can be viewed as a measure of gross profitability. The more times that profits cover interest costs (i.e., the higher the interest coverage ratio), the less likely that the firm will default on its debt obligations and the higher the firm's credit rating, all else equal.

rating prior to even initiating the tender offer, although this is never mentioned in Mr. Poole's account of the events taking place during the relevant time period. That is, if the credit rating agency's opinion was required, it was, at the very least, *before the initiation of the tender offer.* Instead, Mr. Poole contends, on behalf of the Company, that the credit rating agencies were first asked to evaluate the impact of the dividend increase on October 12th, *one day before the completion of the tender offer for TXU's hybrid securities.*

This version of events is just not credible. As noted earlier, if TXU's management was concerned about their credit rating, as they should have been, then they would have initiated a full credit review in the spring or summer of 2004, leaving enough time for completion prior to the initiation of the tender offer in September. A potential dividend increase (and share repurchase)—as well as the general Company restructuring plan—would have been part of that extensive review. It is my opinion that it would not have been prudent for TXU's management to proceed with the tender offer without first having performed detailed financial analysis, including consultation with the credit rating agencies.

Indeed, the Moody's website states that Moody's conducted an analysis of TXU on September 2, 2004, and performed a Financial Reporting Assessment on September 30th, demonstrating the ongoing interaction between TXU and one of the rating agencies (Moody's) during the period surrounding the tender offer, as well as throughout the spring of 2004. This is consistent with my contention that the rating agencies would have been consulted earlier than October 12th. Moreover, there is no mention in the

Moody's timeline of rating agency activities of any rating advisement provided to TXU on October 19th or 20th by Moody's, thereby refuting the Poole account of events.

C. The Possible Impact of Dividend Increases on TXU's Ratings

As noted in the previous section, it makes no sense to argue (as does Mr. Poole) that TXU management would have undertaken a credit rating review of a dividend increase, without first having conducted a review of the full restructuring effort (e.g., the tender offer, asset sales and share repurchases). Thus, the credit rating review should have been undertaken some time prior to the start of the tender offer, not on October 12, 2004, as described by Mr. Poole. Since a full credit rating review of the Company restructuring to be undertaken before the May 2004 press release would have been the appropriate way for management to proceed, it is difficult to ascertain what a narrow credit review of the type envisioned by Mr. Poole would look like. However, in this section, I attempt to examine what management would have been expecting if they had instead chosen to engage the rating agencies to conduct a narrow credit review policy of the impact of only the dividend increase on TXU's credit rating, as contended by Mr. Poole in his January 2005 letter.[27]

---

[27] This counterfactual thought exercise is made even more difficult by the fact that the rating agencies would have been unlikely to accept such a narrow engagement, and would instead have insisted on conducting a comprehensive review of the entire restructuring plan. This is because there are interactive and spillover effects associated with each of the individual elements of the restructuring plan, and a credit rating review

Dividend increases have long been associated with "extraordinary" increases in stock prices.[28] In a seminal survey article, Litzenberger and Ramaswamy find empirical evidence supporting the tax-clientele effect, such that high (low) tax-bracket investors invest in low (high) dividend payout stocks.[29] This is particularly true of utility companies that have typically been attractive to a clientele of shareholders interested in earning a regular stream of dividends.[30] Since relatively low tax-bracket retirees, for example, prefer the steady stream of income from dividend paying stocks such as utilities, these stocks become more valuable when dividend payout ratios increase. Thus, both TXU, management and the credit rating agencies would have anticipated that an increase in dividends would be followed by increases in TXU's stock price.

The October 25th dividend increase had the potential to offset some of the detrimental effects of the other elements of the restructuring plan on TXU's

---

would consider the plan in totality in order to assess the overall impact on TXU's creditworthiness.

[28] For an early academic reference, see J. Ahurony and J. Swary, "Quarterly Dividend and Earnings Announcements, and Stock Return: An Empirical Analysis," *Journal of Finance*, 1980, vol. 35, pp. 1-12. They find a one-day positive and statistically significant abnormal stock return averaging 0.35% on the date of announcement of a dividend increase.

[29] Litzenberger, R.H., and K. Ramaswamy, "The Effects of Dividends on Common Stock Prices: Tax Effects or Information Effects," *Journal of Finance*, vol. 37, May 1982, pp. 429-443.

[30] J. Graham and A. Kumar, "Do Dividend Clienteles Exist? Evidence on Dividend Preferences of Retail investors," *Journal of Finance*, vol. LXI, no. 3, June 2006, pp. 1305-1336, find evidence of a significant tax-clientele effect in the utilities industry.

credit rating (e.g., the reduction in equity book value following the equity liquidation program). Since the dividends were paid out of the proceeds of asset divestitures, then the net effect of the dividend increase on top of the tender offer and other restructurings could have improved TXU's creditworthiness (or, at least, prevented some deterioration in credit ratings). This is because the dividend increase would have made TXU stock more valuable. Upon the announcement on October 25, 2004. TXU common stock increased by 16% in a single day. It would have been more attractive to subsequently issue common stock to finance company investments, thereby leading to the possibility that TXU's leverage would fail and the credit rating would improve. Higher priced equity, therefore, offers the company a bigger equity cushion to protect creditors against negative outcomes. Moreover, options-theoretic structural models of default, like Moody's KMV model, use stock prices *as* an input into the creditworthiness analysis. Thus, it is unlikely that the dividend increase *alone* would have led to the downgrading of TXU by the credit rating agencies. Indeed, if such a downgrade were to occur, it was more likely to be caused by the combination of the asset sales, tender offer, share repurchase, rather than the dividend increase. TXU's contention that the decision to recommend the dividend increase to the Board was held up by the rating agencies' responses is not credible. If anything, they had more to fear from the asset liquidation (initiated in June 2004) and the tender offer (initiated in September 2004) than from the October 2004 dividend increase taken in isolation. Thus, Mr. Poole's contention that TXU management undertook a credit review of the dividend increase, but not of the asset sales or the tender offer makes no sense.

It is my opinion that it was not the response of the credit rating agencies that prevented TXU management from releasing their decision about dividend policy to the public in a timely manner. TXU's financial condition at the end of the third quarter of 2004 was such that the dividend policy change could have actually improved the rating agencies' analysis of TXU's financial ratios, thereby potentially preventing a downgrade in creditworthiness. As noted in Section II of this report, credit ratings depend on a broad array of both qualitative and quantitative factors, thereby making credit rating a time consuming and complex process. However, several of the key inputs into this process are financial ratios constructed using accounting data. Moody's uses a model based on financial ratios "as an important tool in the practice of fundamental credit analysis. The [accounting ratio] model . . . is capable of identifying significant predictors of future default risk. In particular, it validates the important role of interest coverage and leverage in determining default risk."[31] In this section, I examine the impact of the dividend increase alone on TXU's financial ratios, and therefore, by extension, the impact on TXU's credit rating. TXU's management would have had the information required to construct these ratios and, therefore, analyze the impact of the dividend increase, as of the end of the third quarter of 2004, weeks before the end of the tender offer.

Upon analysis of the third quarter 2004 financial ratios used by the credit rating agencies, I found that TXU exceeded some of the peer group medians for

---

[31] L.S. Fons and J. Viswanathan, "A User's Guide to Moody's Default Predictor Model: an Accounting Ratio Approach," *Moody's Special Comment,* December 2004, p. 11.

electrical utilities rated in the BBB to Baa3 range. This is shown in Exhibit 7. which compares TXU's financial ratios to the rating agency financial ratio benchmarks.[32] Examining seventeen financial ratios used by Moody's and S&P to rate electrical utility companies, Exhibit 7, shows that TXU's financial condition during the first nine months of 2004 was such that *its* performance was superior to the peer group medians for investment-grade, BBB and Baa3 rated electrical utility companies published by the rating agencies in six out of the seventeen ratios. The common stock dividend increase examined in isolation would likely have worsened the retained cash flow ratios (retained cash flow to debt; and retained cash flow to capex), but TXU was above the median values for its peers in these ratios. The dividend increase taken in isolation would have had no impact on the remaining four ratios that exceeded rating agency criteria.

For eleven key financial ratios used by the rating agencies to evaluate electrical utilities, TXU was deficient in its performance relative to peer group medians. However, the dividend increase taken in isolation would have had a direct impact on only one of these deficient financial ratios and could actually have brought TXU's performance closer into line with the peer group medians. That is, an increase in the dividend payout, would have brought TXU's common stock dividend payout ratio (which was 49.11% as of the first nine months of 2004) closer into line with peer group median for BBB-rated electrical utilities

---

[32] All ratios are defined in the notes to Exhibit 7. In determining which ratios are deficient relative to rating agency benchmarks, I focused on the nine-month 2004 figures when available.

of 64.20%. All the rest of the seventeen rating agency ratios would have been unaffected by the dividend increase taken in isolation, although they could have been sensitive to the tender offer and the share repurchase, as well as other aspects of the TXU restructuring plan. Thus, Mr. Poole's contention that management was somehow waiting for the credit rating agencies to rule on the advisability of a dividend increase is contradicted by the evidence regarding TXU's financial performance at the time. Not only is it implausible to argue, as Mr. Poole does, that TXU management would conduct a credit rating review of the dividend policy change alone, without having first fully reviewed the entire restructuring plan for its impact on TXU's marginally investment-grade credit rating, but also it is unlikely, using financial ratio analysis, that the dividend increase *taken in isolation* could have caused a rating downgrade.

I also examined the historical relationship between dividend increases and credit ratings for firms other than TXU. As noted above, large dividend increases are quite rare. Examining the entire sample of tens of thousands of companies on Standard & Poor's Computstat database, I only found 24 cases of firms (from any industry) that increased their quarterly dividends by 100% or more over the entire 2000-2006 period. Exhibit 8 shows the results of this analysis. Out of these large dividend increasing firms, 62.5% had no impact on their long-term credit ratings. An additional 8.33% experienced a ratings upgrade. Less than 30% of the observations experienced a ratings downgrade upon announcement of a large dividend increase. Moreover, when considering the subset comprised of only the six observations (including TXU) of BBB rated firms that raised their dividends

by more than 100%, all experienced no change in their credit rating.

One could ask why large dividend increases did not impair credit ratings in more than 70% of the cases shown in Exhibit 8, since common stock dividend payments transfer the firm's assets (e.g., cash) out of the firm, thereby reducing the resources available to repay the firm's debt obligations and potentially increasing credit risk exposure.[33] However, dividend increases in general, and large dividend increases in particular, are devices used by management to signal positive future growth opportunities. Thus, if the rate of growth of future assets anticipated by management exceeds the dissipation in the firm's existing asset base through the payment of dividends, then both the value of debt and equity will increase, thereby causing the company's credit rating to improve (or stay the same) when the common stock dividend payout ratio is substantially increased. The value enhancing benefits of the dividend signal are largest, all else held equal, for firms with less volatile cash flows that are underperforming.[34] Therefore, the dividend signaling benefits to TXU were particularly significant given the large size of the dividend increase, as well as the relative stability of utility cash flows and TXU's poor financial performance vis

---

[33] Using the same logic, asset sales could have conceivably caused ratings downgrades, and therefore, the ratings agencies should have been consulted before TXU began its asset restructuring program.

[34] See A. Chang, P. Kumar, and K. Sivaramakrishnan, "Dividend Changes, Cash Flow Predictability, and Signaling of Future Cash Flows," University of Houston Working Paper, March 9, 2006.

a vis its peer group of BBB/Baa3 rated electrical utilities (see Exhibit 7).

D. TXU's Lack of Compliance With Its Stated Objectives

In his February 23, 2004 teleconference introducing John Wilder as the new CEO of TXU, Wilder communicated his conditions for a dividend increase to the investment community:

> I wouldn't be comfortable making a material change in the dividend policy, until I knew all of our businesses were running at high performance levels and I knew we had more than adequate financial flexibility to withstand any market shocks that the company might have. In my way of thinking and with the business portfolio we have our debt would be net debt to total capital in the 40-45 range and strong coverage ratios of 4.0 or greater. I think we can achieve that by '06 and quite frankly there is a possibility we can achieve that by '05. (page 9, 8K Filing)

The analysis in the previous section (see Exhibit 7) shows that TXU was deficient, relative to rating agency criteria for peer group electrical utilities rated BBB/Baa3, in eleven out of seventeen of the financial ratios considered as important benchmarks for creditworthiness by the credit rating agencies. With deficiencies in eleven out of seventeen key financial ratios, TXU could hardly have been considered as if it was "running at high performance levels." Thus, Mr. Wilder's public disclosures indicated that TXU was not in any condition to increase dividends in October 2004 because of its failure to comply with Wilder's own stated financial conditions for reevaluation of TXU's dividend policy.

Several times over the May—October 2004 period, John Wilder reiterated his fundamental beliefs about dividend increases, and specified financial benchmarks (with slight variations over time) as conditions for dividend increases. In the May 2004 press release, TXU management stated the conditions under which "management would recommend that the Board of Directors reevaluate current dividend policy." (page 5 of the May 2004 press release). These were "the objective of achieving a ratio of total debt to total capitalization below 45 percent and an interest coverage ratio greater than 6 times." (page 5 of the May 2004 press release).

In the September 15, 2004 tender offer, TXU makes vague representations about the possibility of a dividend increase, as follows (page 27):

> As part of its capital management and restructuring program and considering current business and market conditions, TXU Corp.'s management is evaluating whether it should recommend to the TXU Corp. Board of Directors that they reevaluate TXU Corp.'s current common stock dividend policy. TXU Corp. cannot predict the outcome of management's evaluation, when if at all, management would make a recommendation to the Board of Directors to change the current common stock dividend policy, or what management's recommendation might be.

This carefully hedged and overly general statement is inaccurate, because management would have been far along in its evaluation of TXU's dividend policy as of September 15th. More importantly, however, this general statement does not negate the specific conditions revealed in the May 18, 2004 press release and John Wilder's February 23, 2004 and May 18, 2004

presentations describing specific financial conditions that must be fulfilled before the dividend increase would be considered. In fact, couching the general statement above, as quoted from the tender offer, in terms of the "capital management and restructuring program," reveals that the general statement does not nullify the more specific terms of the restructuring program disclosed on May 18, 2004, but instead refers to them. Moreover, on September 28, 2004, John Wilder gave another presentation describing that the dividend payout policy would be reviewed only at the very end of Stage 3 of the restructuring program and only alter certain financial targets had been reached. These targets changed slightly from the May 2004 targets, revealing the updating of the conditions required before a dividend increase could occur. These new conditions were a debt/market capitalization ratio of less than 50%, an interest coverage ratio exceeding 5x, and a debt/EBITDA ratio of less than 3x. Therefore, market participants rationally expected that achievement of these clear benchmarks was a prerequisite for any dividend increase.

An examination of the financial statements for the third quarter of 2004 shows that TXU had not met any of these conditions prior to the 350% increase in dividends on October 22, 2004. As shown in Exhibit 7, the total debt to capitalization ratio for the first nine months of 2004 was 69.32%, higher than either the 45% or the 50% objectives stated in the May 2004 press release and the September 2004 presentation. In addition, TXU did not meet the other updated conditions for a dividend increase specified in the September 2004 presentation. Although the pre-tax interest coverage ratio (EBITDA divided by interest expenses) for the third quarter 2004 alone was 5.77x; the ratio over the nine months ending September 30,

2004 was only 3.10x—far below the objective of 5x. The use of the third quarter interest coverage ratio alone would have been extremely misleading for an electrical utility in the South, since earnings (and therefore interest coverage ratios) are inflated by the hot summer months' high demands for energy usage. Moreover, TXU's Debt/EBITDA ratio as of the end of the third quarter of 2004 was 6.61x, far in excess of the target 3x. Thus, *TXU had not met any of the financial objectives stated in the September 28, 2004 presentation as conditions for the consideration of a dividend policy change that superseded the general statement made in the tender offer dated September 15, 2004.*

E. Management Incentives

What, then, was TXU management thinking? While I cannot presume to put myself in the minds of TXU's top managers, it should be noted that John Wilder had entered into an employment agreement with TXU on February 23, 2004. This agreement provided him with, among other things, performance-based stock awards amounting to an additional 1.5 million shares of TXU common stock. Describing the terms of the Long-Term Incentive Compensation Plan, page 5 of Wilder's Employment Agreement states that Mr. Wilder would receive up to 1 million "Phantom Performance Shares" of TXU common stock if the stock price reached specified threshold stock prices ranging from $29 to $33. In describing the compensation package, the TXU proxy statement dated May 21, 2004 states, "A very significant portion of Mr. Wilder's total expected future compensation (namely his annual bonus, performance units and performance-based restricted stock awards) will only be provided based on the Company's future per-

formance and his compensation is, therefore, directly linked to shareholders' longterm interests." As of March 22, 2004, Mr. Wilder held 1.8 million shares in TXU common stock, more than all other directors and executive officers combined (page 16, May 21, 2004 proxy statement). It seems clear that Mr. Wilder had much to gain from the deviation from the firm's stated objectives and the precipitous, undisclosed increase in dividends, which predictably caused a dramatic increase in TXU's stock price.

IV. Conclusions

In this report, I examine the events leading to the 350% increase in dividends and 50 million shares repurchase approved by TXU's Board of Directors on October 22, 2004. This occurred only nine calendar days after the closing of a tender offer for hybrid debt/equity securities. At no time during the month-long tender period did TXU reveal that a substantial change in dividend policy was under serious consideration. Indeed, this was material information for participants in the tender offer because the hybrid securities that were being tendered had mandatory equity conversion features within very short time horizons and, therefore, had high degrees of "equity-ness." It is my expert opinion that:

- TXU management had been working on this dramatic policy change over an extended period prior to the closing of the tender offer period.
- During the May-October 2004 period, four public statements were issued by TXU regarding a dividend policy change: (1) the press release and Wilder presentation presented on May 18, 2004; (2) the August 10-Q

filing; (3) the tender offer and press release dated September 15, 2004; and (4) the Wilder presentation on September 28, 2004. None of these public disclosures announced that a substantial dividend increase was imminent. To the contrary, TXU management repeatedly stated that any consideration of a change in dividend policy would not take place until 2005, at the earliest.

- The September 28, 2004 presentation, representing the most recent public disclosure prior to the October 13th closing of the tender offer, stated the conditions required before a dividend increase could occur. These statements were misleading and inaccurate, since TXU violated its own disclosed timetable for a dividend increase and failed to meet the financial conditions stated as the prerequisite for the reevaluation of TXU's dividend policy.
- Given the equity-like features of the hybrid securities, the information about a pending dividend increase was material and should have been released prior to the closing of the tender offer.
- Dividend increases in general have positive impacts on equity values (stock prices), and must be analyzed together with other factors to determine their impact on credit ratings.
- TXU's contention that they waited until the receipt of the credit rating agencies' guidance to release the information about the dividend increase is not credible because:

1. The time frame under which the rating agencies ostensibly conducted their review of TXU's issuer rating is unrealistically short.

2. Credit rating agencies would have been consulted far earlier in the process in order to review the impact of the entire restructuring plan—not just the dividend increase or the share repurchase—on TXU's credit rating, which was only marginally investment grade. Thus, the credit rating agencies should have been involved sometime during the spring or summer of 2004, if not earlier. Evidence from the Moody's website supports this view, showing that Moody's performed analysis of TXU on September 2, 2004 and a Financial Reporting Assessment on September 30th, as well as conducted other assessments during the spring of 2004, thereby refuting TXU's management's account as presented in the Poole letter of January 18, 2005. TXU management failed to release material information about the dividend increase to the public in a timely manner.

Respectfully submitted,

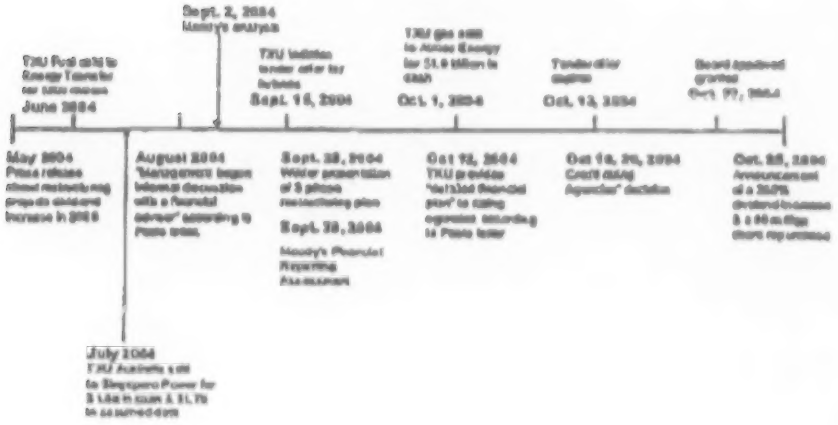
/s/ Professor Linda Allen
Professor Linda Allen

November 26, 2007.

Exhibit 1

Timeline of Selected Events

May 2004 – October 2004



BEST AVAILABLE COPY

Exhibit 2

Curriculum Vita of Professor Linda Allen
Presidential Professor of Finance

Zicklin School of Business	3455 Second Street
Baruch College, CUNY	Oceanside, New York 11572
17 Lexington Avenue	516.766.5369 (home)
New York, New York 10010	646.312.3463 (office) — 646.312.3451 (fax)
LindaAllen@baruch.cuny.edu	Lallen@stern.nyu.edu

http://www.stern.nyu.edu/~lallen

Education

Ph.D. 1984, Economics/Finance, New York University.

B.A. Summa Cum Laude 1975, Queens College, CUNY.

Books

Understanding Market, Credit and Operational Risk: The Value at Risk Approach, with J. Boudoukh and A. Saunders, Blackwell Publishing, Oxford: 2004.

Credit Risk Measurement: New Approaches to Value at Risk and Other Parodists, with A. Saunders, 2nd edition, John Wiley and Sons, New York: 2002.

Capital Markets and Institutions: A Global View, John Wiley and Sons, New York: 1997.

U.S. Patent Pending: An Arrangement For and A Method For Determining Damages in Shareholder Class Action Litigation

Publications

"Meeting *Daubert:* Standards in Calculating Damages for Shareholder Class Action Litigation," *The Busi-*

ness Lawyer, vol. 62, number 3, May 2007, pp. 955-969.

"Loan Underpricing and the Provision of Merger Advisory Services," with S. Peristiani, *Journal of Banking and Finance,* forthcoming.

"A New Theoretically-Grounded Microstructure Trading Model For Calculating Damages in Shareholder Class Action Litigation," *Stanford Journal of Law, Business and Finance,* vol. 12, no. 1, Autumn 2006, pp. 61-83.

"Cyclicality in Catastrophic and Operational Risk Measures," with T. Bali, *Journal of Banking and Finance,* forthcoming.

"The Informational Efficiency of the Equity Market As Compared to the Syndicated Bank Loan Market," with A. Gottesman, *Journal of Financial Services Research,* August 2006, vol. 30, no. 1, pp. 5-42.

"Incorporating Systemic Influences Into Risk Measurements: A Survey of the Literature," with A. Saunders, *Journal of Financial Services Research,* vol. 26, no. 2, 2004, pp.161-191.

"The Basel Capital Accords and International Mortgage Markets: A Survey of the Literature," *Financial Markets, Institutions and Instruments,* vol. 13, no. 2, 2004, pp. 41-108.

"Comment on "Evidence on the Efficacy of Interest Rate Risk Disclosures by Commercial Banks," *International Journal of Accounting,* vol. 39, 2004, pp. 253-255.

"Cyclicality in the Catastrophic Risk of Financial Institutions," with T. Bali and Y. Tang, in *Operational Risk Modelling and Analysis: Theory and Practice,* M. Cruz, editor, Risk Books, 2004, pp. 209-246.

"The Path to Basel II Adoption," with A. Saunders, *Journal of Financial Services Research,* Guest editors, vol. 26, no. 2, 2004, pp.101-102.

"The Role of Commercial Bank Advisors in Mergers and Acquisitions," with J. Jagtiani, S. Peristiani, and A. Saunders, *Journal of Money, Credit and Banking,* vol. 36, no. 2, April 2004, pp. 197-224.

"Issues in the Credit Risk Modeling of Retail Markets," with G. DeLong and A. Saunders, *Journal of Banking and Finance,* April 2004, vol. 28, no. 4, pp. 727-752. [Presented at the Wharton conference on Credit Risk Modeling and Decisioning, May 2002 and the Federal Reserve Bank of Philadelphia Conference on the Payment System, April 2003.]

"The BIS Basel International Bank Capital Accords," with A. Saunders, in F.D.S. Choi, editor, *International Accounting and Finance Handbook,* 3rd edition, New York: John Wiley and Sons, 2003, pp. 3.1-3.24.

"Cyclical Effects in Credit Risk Ratings and Default Risk," with A. Saunders, *Credit Ratings: Methodologies, Rationale and Default Risk,* Michael Ong, ed. London: Risk Books, 2002, pp. 45-79.

"Tough Love in Risk Management: The Market as Financial Parent," *Journal of Economics and Business,* January/February 2002, Volume 54, Number 1, pp. 3-6.

"Comments on 'Credit Ratings and the BIS Reform Agenda,'" in R. Levich, ed., *Ratings, Rating Agencies, and the Global Financial System,* Kluwer Academic Publishing, 2002.

"Further Evidence on the Information Content of Bank Examination Ratings: A Study of BHC-to-FHC Conversion Applications," with J. Jagtiani and J.

Moser, *Journal of Financial Services Research,* vol. 20, no. 2/3, 2001, pp. 213-232.

"The Risk Effects of Combining Banking, Securities, and Insurance Activities," with J. Jagtiani, *Journal of Economics and Business,* 2000, 52, pp. 485-497.

"Losing Your Tail on the Repo Market: The Story of Robert Citron," *The Arbitrageur,* 1, 1, 1998, pp. 13-20.

"Debt Masquerading as Preferred Stock: Reordering the Pecking Order," *Roundtable Group Online,* April 1998.

"Risk and Market Segmentation in Financial Intermediaries' Returns," with J. Jagtiani. Presented at the Wharton 1997 Conference on Risk Management in Banking. *Journal of Financial Services Research,* 12:2/3, 1997, pp. 159-173.

"Operational Efficiency in Banking: An International Comparison Reply," with A. Rai, *Journal of Banking and Finance,* 21, 1997, pp. 1451-1455.

"CMO, IO, PO, and Other Potentially Toxic Letters of the Alphabet," *Corporate Finance Review,* March/April 1997, pp. 5-11.

"Valuation of the Operating Flexibility of Multinational Corporations," with C. Pantzalis, *Journal of International Business Studies,* 1997, pp. 633-53.

"Bank Charter Values and Capital Levels: An International Comparison," with A. Rai, *Journal of Economics and Business,* August 1996, 48, pp. 269-284.

"Interest Rate Risk Subsidization in International Bank Capital Requirements," with J. Jagtiani and Y. Landskroner, *Journal of Economics and Business,* August 1996, 48, pp. 251-267.

"Operational Efficiency in Banking: An International Comparison" with A. Rai, *Journal of Banking and Finance,* May 1996, pp. 655-672.

"Deposit Insurance and Regulatory Forbearance: Are Caps on Insured Deposits Optimal?," with J.F. Dreyfus and A. Saunders, *Journal of Money, Credit, and Banking,* August 1994 Part I, pp. 412-438.

"Deposit Insurance and Bank Closure Policy: The Case of the Israeli Banking System," Bank of Israel *Banking Review,* 1994, No. 4, pp. 31-55. (In Hebrew: 26-5, 12.)

"Economies of Scale and Scope in International Banking," with A. Rai, *Journal of International Financial Markets, Institutions, and Money,* 1993 3(2), pp. 1-31.

"Forbearance and Valuation of Deposit Insurance as a Callable Put," with A. Saunders, *Journal of Banking and Finance, 17,* 1993, pp. 629-643.

"Bank Capital and Deposit Insurance Regulations," in *Global Risk Based Capital Regulations: Capital Adequacy,* edited by A. Zissu and C. Stone, Irwin Professional Publishing, Burr Ridge: 1991

"Bank Window Dressing: Theory and Evidence," with A. Saunders, *Journal of Banking and Finance,* 16, 1992, pp. 585-623.

"Joint Ventures in Poland: A Discussion," in *Business Finance in Less Developed Capital Markets,* edited by K. Fischer and G. Papaioannou, Greenwich Publishing Group, 1992.

The Pricing of Retail Deposits: Concentration and Information," with A. Saunders and G. Udell, *Journal of Financial Intermediation,* 1, 4, 1991, pp. 335-361.

"Bank Acquisitions and Ownership Structure: Theory and Evidence," with A.S. Cebenoyan, *Journal of Banking and Finance,* 15, 1991, pp. 425-448.

"Bank Size, Collateral and Net Purchase Behavior in the Federal Funds Market: Empirical Evidence," with A. Saunders and S. Peristiani, *Journal of Business,* October 1989, pp. 501-16.

"Cash-Futures Arbitrage and Forward-Futures Spreads in the Treasury Bill Market", with T. Thurston, *Journal of Futures Markets,* October 1988, pp. 563-73.

"The Determinants of Bank Interest Margins: A Note," *Journal of Financial and Quantitative Analysis,* June 1988, pp. 231-35.

"Equilibrium Credit Rationing: A Synthesis of the Literature," *Salomon Brothers Center for the Study of Financial Institutions Monograph Series in Finance and Economics. Occasional Paper,* June 1987.

"The Large-Small Bank Dichotomy in the Federal Funds Market," with A. Saunders, *Journal of Banking and Finance,* June 1986, pp. 219-230.

Work In Progress

"The Information Content of Quarterly Earnings in Syndicated Bank Loan Prices," with H. Guo and J. Weintrop.

"The Impact of Joint Participation on Liquidity in the Equity and Syndicated Bank Loan Markets," with Lin Peng and Aron Gottesman.

"Revisiting the Level Playing Field: International Lending Responses to Divergences in Japanese Bank Capital Regulations From the Basel Capital Accord," with Suparna Chakraborty.

Academic Experience

September 2007-Present	*Presidential Professor of Finance*	Baruch College, CUNY
September 1989-Present	*Tenured Faculty*	Zicklin School of Business Baruch College, CUNY
May 2000-Present	*Adjunct Professor of Finance*	Zicklin School of Business Stern School of Business NYU
September 1987-August 1989	*Assistant Professor of Finance*	Hofstra University Business School
September 1987-August 1989	*Visiting Research Fellow*	Salomon Brothers Center- NYU
February 1984-August 1987	*Assistant Professor*	Queens College, CUNY

Selected Consulting Experience

Expert Witness Testimony:
Class Action Shareholders Fraud Litigation (10b-5) Liability and Damages

Expert
Litigation involving: Derivatives, Syndicated Bank Loans, Creditworthiness

Board Member—Aries Opportunities Master Fund

Lehman Brothers Training Seminars	Credit Risk Measurement Seminars

Bank of Israel Research Division	Consultant- Banking Specialist
SEC Investment Management Seminar	New York Institute of Finance

Grants and Fellowships

2003-2005 KPMG/University of Illinois Business Risk Measurement Research Grant

2002 Research Award: Finance-research.net

1998-99 Fulbright Scholarship Competition.

PSC-CUNY Grant, 1984-1985, 1986-1987, 1989-1990,1994-1995.

National Science Foundation Allocation, 1988-1989.

Hofstra University Center for Scholarly Research, 1988-1989.

Queens College Faculty-in-Residence Grant, 1985 and 1987.

Alumni Association of Queens College Allocation 1986.

Sloan Foundation Grant, 1977-1978 and 1978-1979.

New York University Penfield Fellowship.

Academic Presentations—Since 2005

ProBanker Conference, Maastricht	NYU/Federal Reserve Conference 2005, 2006
Indiana University seminar	Bank of Israel/Hebrew University Conference
New York University seminar	Bank of Greece Conference

FDIC/JFSR Conference

Laval University (Canada) seminar

Financial Management Association 2005, 2006, 2007

Professional Memberships

American Finance Association

Financial Management Association

Phi Beta Kappa

Eastern Finance Association, Executive Board Member

National Association of Corporate Directors

Standard & Poor's Council of Academic Advisors

Chair, Special Topics, Program Committee of the Financial Management Association 2008 Meeting

Editorial Positions

Associate Editor, *Journal of Banking and Finance*

Associate Editor, *Journal of Economics and Business*

Associate Editor, *Multinational Finance Journal*

Associate Editor, *Journal of Multinational Financial Management*

Board of Advisors, *The Financier*

Board of Advisors, Merrill Lynch Center for the Study of Financial Institutions at Hofstra University

Special issues editor, *Journal of Banking and Finance, Journal of Financial Services Research, Journal of Economics and Business*

Exhibit 3
Documents Examined

SEC Filings

David Poole Letter dated January 18, 2005

Philippe Solomon Letter dated December 13, 2004.

First Amended Complaint with Exhibits dated November 28, 2005.

Standard & Poor's Compute database. Moody's website.

Tender Offer, September 15, 2004.

John Wilder Presentation dated September 28, 2004

May 18, 2004 Press Release and Presentation by John Wilder

White, L. "An Analysis of the Credit Rating industry," in *Credit Rating: Methodologies, Rationale and Default Risk*, Michael Ong, editor, Risk Books, New York: 2002, pp. 85-102.

Hamilton, DT, R. Cantor and S. Ou, "Default and Recovery Rates of Corporate Bond Issuers," Moody's Special Comment, February 2002.

Moody's Special Comment, "Financial Ratio Medians for Global Investment Grade Corporates," page 6, January 2001.

S&P *Corporate Ratings Criteria,* 2002 and 2006.

Moody's, *Financial Ratio Medians The Global Investment Grade Companies,* January 2001.

R. Cantor and F. Packer, "The Credit Rating industry," *Federal Reserve Bank of New York Quarterly Review,* Summer/Fall 1994, pp. 1-25.

P. Varma, R. Cantor and D. Hamilton, "Moody's Rating Actions, Reviews and Outlooks: Quarterly Update October 2004,"*Special Comment.*

J. Aharony and J. Swary, "Quarterly Dividend and Earnings Announcements, and Stock Return: An Empirical Analysis," *Journal of Finance,* 1980, vol.35, pp. 1-12.

Litzenberger, R.H., and K. Ramaswamy, "The Effects of Dividends on Common Stock Prices: Tax Effects or information Effects,"*Journal of Finance,* vol. 37, May 1982, pp. 429-443.

J.S. Fons and J. Viswanathan, "A User's Guide to Moody's Default Predictor Model: an Accounting Ratio Approach," *Moody's Special Comment,* December 2004.

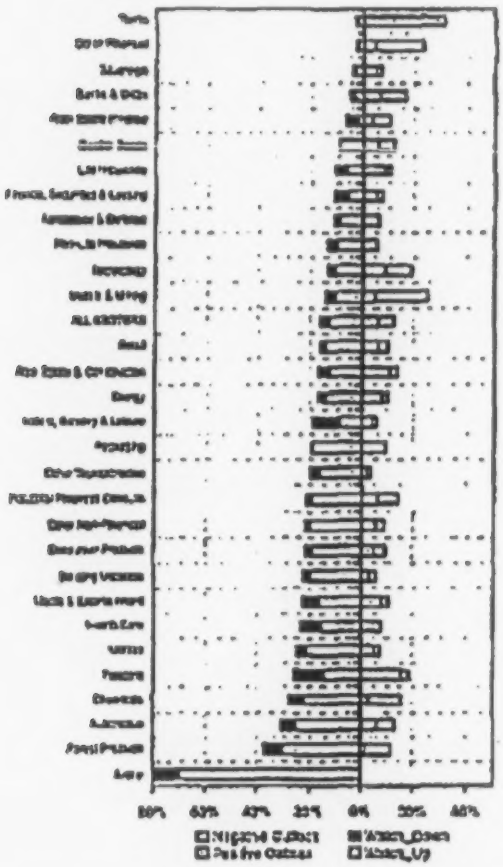
P. Kumar, "Shareholder-Manager Conflict and the Information Content of Dividends," *Review of Financial Studies,* vol. I, no. 2, Summer 1988, pp. 111-136.

A. Chang, P. Kumar, and K. Sivaramakrishnan, "Dividend Changes, Cash Flow Predictability, and Signaling of Future Cash Flows," University of Houston Working Paper, March 9, 2006.

J. Graham and A. Kumar, "Do Dividend Clienteles Exist? Evidence on Dividend Preferences of Retail Investors," *Journal of Finance,* vol. LXI, no. 3, June 2006, pp. 1305-1336.

Exhibit 4

Reviews and Outlooks



Source: P. Varma, R. Cantor and D. Hamilton, "Moody's Rating Actions, Reviews and Outlooks: Quarterly Update October 2004," *Special Comment*, p. 6.

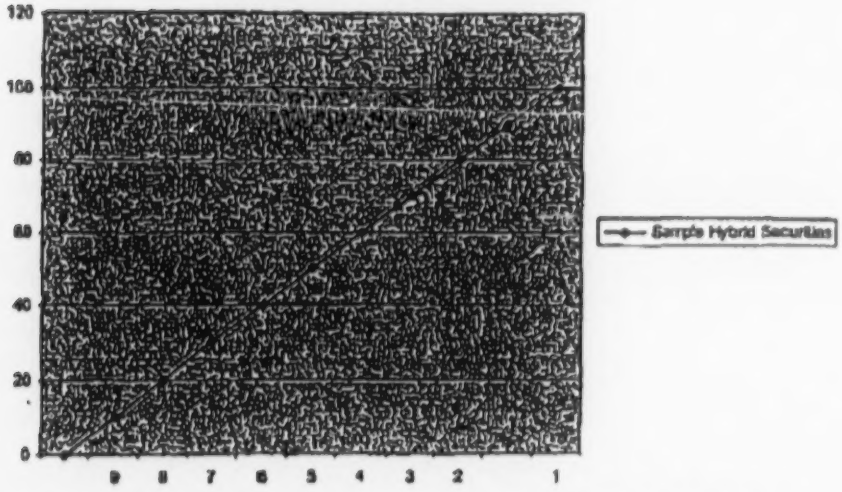
Exhibit 5

		Exhibit »	
	Quarterly Dividend Changes in the Utility Industry		
Year	Average % Change in Dividends	No. of Companies	#Cos. With Dividend Increase>350%
2000	1.85%	371	1
2001	0.02%	458	0
2002	-4.24%	451	0
2003	0.32%	438	0
2004	19.50%	442	3
2005	0.61%	457	0
2006	3.51%	456	1
Source: S&P Compustat Database			
Dividend announcements are grouped by year according to the announcement date.			

Exhibit 6

Relative Equity Impact

Sample Hybrid Securities



Source: S&P Corporate Ratings Criteria, 2002, pages 98-99.
Note: The scale presented here is intended as a communication device. It is not a substitute for analysis, nor should it be interpreted as a tool for quantification of hybrids with respect to ratio calculations. Indeed, those seeking to reduce hybrid analysis to formulas could be harboring a delusion regarding the nature of the credit rating primes. The analytical complexity of hybrids reminds us once again that ratings are an art, not science!
List of Securities in Graph:
1=Common Equity
2=Mandatory conversion preferred-within 3 years (ex. PERCS, PRIDES)
3=Mandatory conversion debt-within 3 years
4=Convertible preferred-Perpetual tax deductible preferred (ex. UK MIPS)
5=Conventional perpetual preferred 5 year no call
6=Deferrable payment preferred (trust preferred)— 25+ years remaining life
7=Deferrable payment debt (MIDS)—25+ years remaining life
8=Convertible preferred—15+ years
9=Various preferred—15+ years

Exhibit 7

Exhibit 7					
TXU Financial Ratios v. Moody's and S&P Benchmarks for Electrical Utilities					
	TXU Financials for 2004		Rating Agency Benchmarks		
	Q1-Q3	Q3 only	Moody's Baa1	Moody's Baa3	S&P BBB
TXU's Ratios Are Better Than Rating Agency Benchmarks:					
Return on Capitalization	13.88%	7.17%	25.01%	8.00%	
Pretax Interest Coverage	4.10	6.77	3.85	2.75	
Retained CF/Debt	27.43%	14.78%	40.62%	7.02%	
Retained CF/Capex	538.79%	3175.42%	122.20%	87.87%	
EBIT/Preferred Div	64.69	148.00			2.70
Net Cash Flow/capex	109.02%	1191.95%			100.20%
TXU's Ratios are Deficient Relative to Rating Agency Benchmarks.					
Common Dividend Payout	49.11%	5.57%			64.20%
Operating Margin	7.16%	20.67%	14.99%	9.00%	
FFO Interest Coverage	248.56%	181.15%	724.00%	195.00%	380.00%
EBITDA-capex/Interest	205.57%	546.22%	887.00%	360.00%	
Total Debt/Capitalization	69.32%		48.43%		58.10%
EBIT/Interest	193.66%	447.86%			250.00%
Return on Equity	5.06%	14.03%			9.80%
ST Debt/ Capital	15.75%				11.20%
Preferred Stock/Capital	0.73%				2.70%
Common Stock/Capital	30.68%				39.60%
FFO/Debt	12.14%				18.10%
TXU Management's Benchmarks to Trigger Dividend Policy Reevaluation:					
EBITDAR/Interest	3.10	5.77			
Debt/EBITDA	6.61				
Total Debt/Capitalization	69.32%				
Sources:					
Moody's "Financial Ratio Medians for Global Investment Grade Corporates," January 2001.					
Standard & Poor's "Corporate Ratings Criteria," 2006.					
TXU Financial Data are obtained from quarterly 10-K filings for Q2 and Q3 2004, and dated 11/10/2004.					

Notes to Exhibit 7: Definitions of Financial Ratios

Operating Margin	(Operating Revenue minus Operating Expenses) divided by Operating Revenue
Retained CF/Capex	(Net income + depreciation + amortization + dividends + deferred taxes & noncash items)/capital expenditures
EBIT/Preferred Div	Earnings Before Interest & Taxes/Preferred Stock Dividends
Net Cash Flow/capex	Net Cash Flow/capex
Total Capitalization	Total Debt plus book value of equity

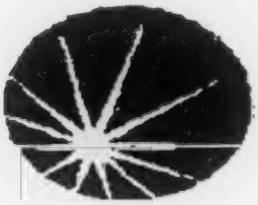
EBITDA/Interest Expenses	Earnings Before Interest, Taxes, Depreciation & Amortization divided by Interest Expenses=pretax interest coverage ratio
Retained CF/Debt	Retained cash flow/Debt
Return on Equity	Return on Equity
FFO/Debt	Funds From Operations/Total Debt
FFO Interest Coverage	Funds From Operations/Interest Expenses
EBITDA-capex/Interest	(Earnings Before Interest, Taxes, Depreciation &Amortization minus capital expenditures)/Interest Expenses
EBIT/Interest	Earnings Before Interest & Taxes/Interest Expenses
Common Dividend Payout	Common Stock Dividends / Net Income
Return on Capitalization	Net Income /Total Capitalization
Preferred Stock/Capital	Preferred Stock/Total Capitalization
Common Stock/Capital	Common Stock/Capitalization
ST Debt/Capital	Short-term Debt/Total Capitalization
Total Debt/ Capitalization	Total Debt/Total Capitalization
Debt/EBITDA	Total Debt/Earnings Before Interest, Taxes, Depreciation &Amortization

Exhibit 8

	Impact of Large Rating Increases (>100%) on Long-Term Credit Ratings 2000-2006			
	No. of Dividend Increases > 100%	No. Ratings Downgrade	No. Ratings Upgrade	No Change Ratings
A-	4	1	1	2
BBB+	4	0	1	3
BBB	6	0	0	6
BB+	1	1	0	0
B+	1	0	0	1
No Rating Info	8	5	0	3
Total	24	7	2	15
% Total		29.17%	8.33%	62.50%

APPENDIX G

Merrill Lynch Global Power & Gas Leaders Conference

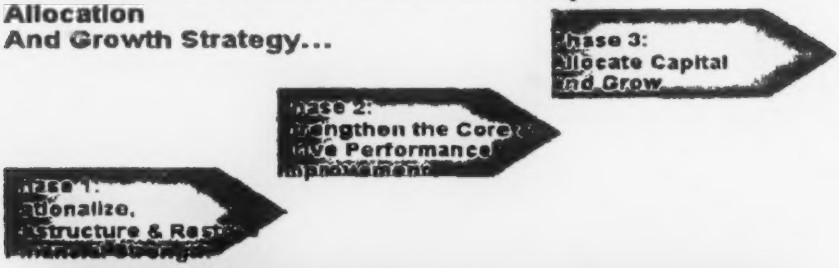


TXU

C. John Wilder
Chief Executive Officer

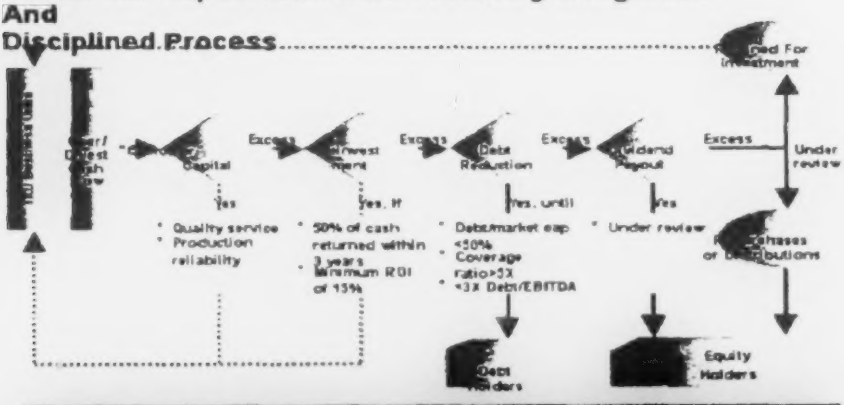
September 28, 2004

The Third Phase Will Establish TXU's Capital Allocation And Growth Strategy...



What We Needed To Do	How We Did It/ How We Are Doing It
• Develop rigorous cash stewardship and capital allocation philosophy • Leverage distinctive capabilities to grow	• Implement capital allocation philosophy • Pursue value-creating growth opportunities

...With Our Capital Allocation Following A Rigorous And Disciplined Process



Given cash flow expectations, we must determine our long-term capital allocation policy:

- *How much cash should we re-invest?*
- *What are the big growth opportunities that can provide excess return over our cost of cap*
- *How much cash should we return to shareholders?*

BEST AVAILABLE COPY

APPENDIX H

WILLKIE FARR & GALLAGHER LLP

PHILIPPE M. SALOMON
212 778.8262
psalomon@willkie.com

787 Seventh Avenue
New York NY 10019-6009
Tel: 212 728 8000
Fax: 212 728 8111

December 13, 2004

BY FEDERAL EXPRESS

Eric H. Peterson, Esq.
Executive Vice President
and General Counsel
TXU Corp.
1601 Bryan Street
Dallas, Texas 75201

Re: TXU Corp. Tender Offer

Dear Mr. Peterson:

This Firm represents three New York Stock Exchange publicly traded closed-end funds, all of which are managed by Flaherty & Crumrine Incorporated ("Flaherty"), an investment advisor. The three closed-end funds previously owned 425,000 TXU Corporate Units, which were tendered to TXU on October 13, 2004, under the terms of the tender offer announced on September 15, 2004 (the "tender offer"). On the three funds' behalf, and at the request of Flaherty, I write this letter regarding the apparently incomplete and misleading disclosures made by TXU Corp. ("TXU" or the "Company") respecting its dividend policy and more specifically, as it related to the tender offer.

Our Clients' TXU Holdings

The three funds managed by Flaherty are the Flaherty & Crumrine Preferred Income Fund, the Flaherty & Crumrine Preferred Income Opportunity Fund, and the Flaherty & Crumrine Claymore Preferred Securities Income Fund (collectively, the "Funds"). As of September 15, 2004, the Funds owned in the aggregate 425,000 TXU Corporate Units CUSIP No. 873168504 (the "shares")—held in varying amounts. Specifically, Flaherty held 30,000 shares in the Flaherty & Crumrine Preferred Income Opportunity Fund, 30,000 shares in the Flaherty & Crumrine Preferred Income Fund, and 365,000 shares in the Flaherty & Crumrine/Claymore Preferred Securities Income Fund. When those shares were tendered, at the tender price of $52.28 per share, the Funds received approximately $22.2 million dollars.

Disclosures Regarding TXU's Dividend Rate

TXU reduced its dividend by eighty percent in October of 2002, after reporting serious financial problems in one of the company's European units. After TXU's common stock price plummeted as a result of that announcement, a securities fraud class action lawsuit encaptioned *Schwartz v. TXU Corp.*—was filed against TXU in the United States District Court for the Northern District of Texas. The combination of the market reaction to the dividend cut and the *Schwartz* lawsuit undoubtedly put TXU on notice that the market price for TXU securities was highly sensitive, and would react swiftly and forcefully, to dividend changes announced by the Company.

On September 15, 2004, TXU publicly released its "Offer to Purchase for Cash" (the "Offering Document") which was incorporated as an exhibit to the

Tender Offer Statement filed with the Securities and Exchange Commission. No doubt with the foregoing background in mind, included within the Offering Document—as well as within a contemporaneous Company press release—was the following neutral statement regarding TXU's plans to consider modification of its dividend policy:

> As part of its capital management and restructuring program and considering current business and market conditions, TXU Corp.'s management is evaluating whether it should recommend to the TXU Corp. Board of Directors that they reevaluate TXU Corp.'s current common stock dividend policy. TXU Corp. cannot predict the outcome of management's evaluation, when, if at all, management would make a recommendation to the Board of Directors to change the current common stock dividend policy, or what management's recommendation might be.

Until the tender offer closed on October 13, 2004, TXU provided the market with no further disclosure that a dividend change was imminent, save the single reiteration that a dividend change was "under review." *See* Presentation at the Merrill Lynch Conference on September 28, 2004.

Nevertheless, on October 22, 2004, a mere nine (9) days after the tender offer closed, the TXU Board of Directors met and approved a dramatic and substantial increase in the TXU dividend policy and rate. According to the Company's press release disclosed on October 25, 2004, the Board approved a new annual dividend rate of $2.25—a three-hundred and fifty percent increase over the previous quarter. Not unexpectedly, upon the Company's public disclosure of the dividend's rate increase, the price of TXU's com-

mon stock immediately rose by nearly ten dollars per share, a sixteen percent increase from the prior day's closing price.

Certainty Of A Dividend Rate Increase

The decision by the Board of Directors to approve a substantial increase in the TXU dividend rate did not simply happen spontaneously on October 22, 2004. These decisions are more typically made in a series of rather detailed, analytical steps orchestrated in conjunction with senior management. Accordingly, between the period from September 15, 2004 and October 13, 2004, the Company was in a position to disclose more precisely and clearly "when, if at all" management would make a recommendation to the Board regarding the dividend policy change. Indeed, in light of the TXU's dramatic "capital management and restructuring program" which had been ongoing for months, it appears most probable that the plans for a dividend change, and the range and amount thereof, were the subject of ongoing consideration, discussion and analysis, sufficiently formulated and concrete, during the period between September 15 and October 13, 2004, that more specific disclosures were mandated under the federal securities laws.

The timing of the dividend disclosure on October 25, 2004, is not only curious but also suggestive of a clear motive to mislead the investing public. TXU management knew, or should have known, that disclosure of a change in the dividend policy, coupled with any extraordinary increase in the actual rate, would cause the price of TXU common stock to rise dramatically. Management and the Board also understood and appreciated that the tender offer price was determined by the average trading price of TXU's common stock during the period from Septem-

ber 20 to October 8, 2004 (the "pricing period"). Accordingly, the Company's management, and its Board of Directors, knew, or should have known, that an appropriate disclosure during the tender period would result in an increase in TXU"s common stock price during the pricing period, resulting in a corresponding increase in TXU's payment to the tenderers.

Consequently, TXU's management and Board understood that during the tender period, disclosure of a dividend increase, and the attendant increased price for the tender, were essentially antithetical and inconsistent with its long term, overall restructure program. That restructuring contemplated, *inter alia*, an accelerated repurchase of 52.5 million of its common stock, and removing a majority of its "complicated" convertible securities from its balance sheet. *See, e.g.*, TXU News Release "TXU Closes on Stock Repurchase Agreement—TXU Completes Phase One of Restructure Plan," dated November 29, 2004.

A proper disclosure during the tender period of the new dividend program that was finally made public on October 25, 2004, would have resulted in several adverse consequences. Firstly, as noted above, the cost of eliminating the equity-linked, convertible debt securities would be substantially increased by effectively raising the anticipated cost of the tender offer. Secondly, equally adverse was the substantial likelihood that many holders would not tender, opting to hold the common stock that would be issued in November, 2004, collecting the increased dividend, and holding the balance of their convertible securities at their appreciated value.

I also observe that the dividend decision disclosed on October 25, 2004, was undoubtedly long in the making. Since early 2004, TXU had been imple-

menting a phased-in restructure program of which the tender offer and dividend plan had been an integral part. *See* TXU News Release, dated November 29, 2004, *supra*. It defies reason to believe that no action respecting the increased dividend rate was considered, if not virtually approved, during the period from September 15, 2004, to October 13, 2004. This material decision certainly did not reach fruition during the slim time line between October 13 and October 22, 2004. Alternatively, TXU had already reached a decision regarding its dividend program and had concluded to increase its dividend rate as of, or prior to, September 15, 2004—a scenario that I currently am prepared to hold in abeyance.

Our Client's Demand

As set forth above, knowledge that TXU's Board would modifying its dividend policy, and substantially raise its rate, would have changed the total mix of information available to our clients, and to the market in general. Indeed, had our clients been apprised of this information in a timely manner, Flaherty would not have tendered the securities on behalf of the Funds. By tendering, as opposed to holding the TXU securities, the Funds lost approximately $2.5 million in value with respect to their TXU investment.

On behalf of the Funds, this letter is intended to inform you that they are prepared to accept a total payment from TXU in the amount of two-million five-hundred thousand dollars ($2.5 million) in full settlement and compromise of all claims that the Funds have against TXU. Of course, the Funds are prepared to issue appropriate releases in favor of TXU and to maintain the confidentiality of such a settlement. In this regard, if I do not receive a response by the close

of business on January 14, 2005, my clients have instructed this Firm to enforce their rights to the fullest extent permitted by law.

I look forward to your favorable response.

Very truly yours,

/s/ Philippe M. Salomon
Philippe M. Salomon

cc: Flaherty & Crumrine Incorporated

APPENDIX I

[Logo]

David P. Poole
Senior Vice President &
Associate General Counsel

January 18, 2005

TELECOPIED TO (212) 723 8111
AND STANDARD U.S. MAIL

Mr. Phillippe M. Salomon
Willkie Farr & Gallagher LLP
787 Seventh Avenue
New York, NY 10019

Re: TXU Corp. Corporate Units Tender Offer

Dear Mr. Salomon:

Thank you for your letter of December 13, 2004. As Associate General Counsel for Litigation I represent TXU Corp. with regard to this matter. Please direct any future communications related to this matter to me. As I will describe below, the characterizations in your letter about the process and timing of our management's evaluation of options regarding dividend policy and our Board's decision to increase the dividend rate are factually incorrect. Our tender offer documentation and/or other public statements did not in any way mischaracterize the state of facts either at the time TXU's tender offers were launched or at the time they were closed.

Disclosures Regarding TXU's Dividend Rate

You are correct about our understanding of the relationship of the price of TXU Corp. securities to dividend changes announced by the company. In fact,

as I am sure you understand, we would be equally concerned about suggesting to the market that dividend increase was imminent, if there was a possibility that management would not recommend such an increase to the Board or that the Board would ultimately not approve such an increase.

In August of 2004, our management indicated to the Board that, while our financial plan at that time did not contemplate a change in the dividend policy for at least 18 months, management was planning to undertake an evaluation of the current dividend in light of current business and market conditions. In this regard, management began informal discussions with a financial advisor to obtain their assistance in evaluating TXU's dividend policy.

At the time of the launch of the tender offers on September 15, 1004, TXU management had only undertaken preliminary market and financial analyses regarding dividend policy and had yet to prepare a detailed financial analysis of various scenarios involving changes to the dividend policy. Disclosure about a review of the dividend policy would not have been appropriate at that time. Nonetheless, due to the launching of the tender offers, we concluded, after consultation with counsel and the dealer-managers for the tender offers, that it was appropriate to disclose our dividend policy was under review. We also felt it was important that our disclosures be balanced so as not to suggest that any decision had been made regarding the dividend policy—there had not been any decision and, in fact, all that had occurred was some preliminary analysis.

During the pendency of the tender offers and at the time of closing the tender offers, we evaluated the facts to determine whether our disclosures were ac-

curate. We discussed the facts with counsel and the dealer-managers. Based on the facts during the term of the tender offers and on October 13, 2004, we concluded that it was not appropriate to change the disclosure regarding management's evaluation of TXU dividend policy because during the term of the tender offers and on October 13, 2004 management's evaluation was not yet complete and management was not in position to make a recommendation to the Board regarding dividend policy increase, decrease, or no change. On October 13, 2004, other than the brief discussion in August and notice of a possible Board meeting in October to dismiss dividend policy, the TXU Corp. Board of Directors was not provided by management any detailed market and financial information about possible changes in dividend policy.

Certainty of a Dividend Increase

You are correct that the decision by the TXU Corp. Board of Directors to increase the dividend rate did not happen spontaneously on October 22. The Board and management did undertake a series of detailed steps prior to 1) management being a position to consider making a recommendation of a change in dividend policy to the Board and 2) the Board considering management's recommendation and ultimately increasing the dividend rate. However, during the period from September 15, 2004 through October 13, 2004, the facts did not support any change to the disclosure included in the tender offer documentation as such disclosure accurately described the status of the analysis of the dividend policy.

Subsequent to the launch of the tender offers in September, management continued in work with its financial advisor on various alternatives for TXU's dividend policy, including an alternative that sug-

gested no change to the dividend rate of $0.50 per year. There were a number of criteria that management considered prior to making a recommendation to the Board. These criteria included a number of items, including, among others, the impact of various distribution policies on TXU Corp.'s equity and debt investors, financial strategy, and credit profile. One critical aspect of this analysis was the impact of changes in dividend policy and capitalization on the credit ratings of debt securities of TXU Corp. and its subsidiaries. To assist in this evaluation, TXU Corp. engaged Moody's and Standard & Poor's to provide a ratings advisory service with respect to the impact on the ratings of these possible changes. Absent feedback from the agencies that a set of proposed changes would not result in a downgrade, management was not in a position to recommend changes in dividend policy to the Board.

As the tender offers progressed, management continued to evaluate the financial impacts of various scenarios involving the dividend rate. It was not until October 12, 2004 that management was in a position to provide the rating agencies a detailed financial plan that would support the agencies' evaluation of changes to TXU's dividend policy. Without having a response from the rating agencies as to their views on the financial plan, management was not in a position to know what it would recommend to the Board regarding possible changes to the dividend policy. In fact TXU management was not certain at that point that they would be in a position to recommend any change in dividend policy.

On October 19, 2004, management provided the Board materials to be discussed at a meeting scheduled for October 21, 2004. This material included

the financial plan for TXU that was to be presented to analysts and the public on October 25, 2004. In addition, the material included a detailed presentation regarding the status of management's evaluation of TXU's cash distribution policy. On October 19, management had not received feedback from the rating agencies on the materials being reviewed by the agencies. On October 19, management was not yet in a position to make a recommendation to the Board regarding possible changes to the cash distribution policy.

On October 19 and 20, 2004, management was informed by the rating agencies that based upon their analysis of the materials presented to them, they did not believe that a change in the dividend rate coupled with a repurchase of additional shares of TXU common stock would result in any adverse action by them with respect to TXU's credit ratings. Based on this feedback, at the October 21, 2004 Board meeting, management made its recommendation to the Board that they consider increasing the annual dividend rate to $2.25 per share and authorizing the repurchase of an additional 50 million shares of TXU Corp. common stock.

After considering the materials presented on October 21, the Board reconvened late in the day on October 22, 2004 to discuss management's recommendation and eventually approved the changes recommended by management. This information was promptly disclosed prior to the opening of trading on the next business day, Monday, October 25, 2004.

As described, contrary to the conjecture in your letter of December 13, 2004, this material decision did "reach fruition during the slim time line between October 13, 2004 and October 22, 2004."

Summary

We understand your clients' regrets that they participated in the Corporate Units tender offer in light of the performance of TXU common stock subsequent to the time of such tender offer. However, we feel that our disclosure was correct and adequate at the time such tender offer was launched, throughout the term of such tender offer and at the time it closed. We believe that many holders of the Corporate Units considered the disclosure of our review of the dividend policy, as well other information about TXU Corp., and concluded that they would be better off holding their securities. In fact, approximately 35% of the Corporate Units were not tendered pursuant to our offer.

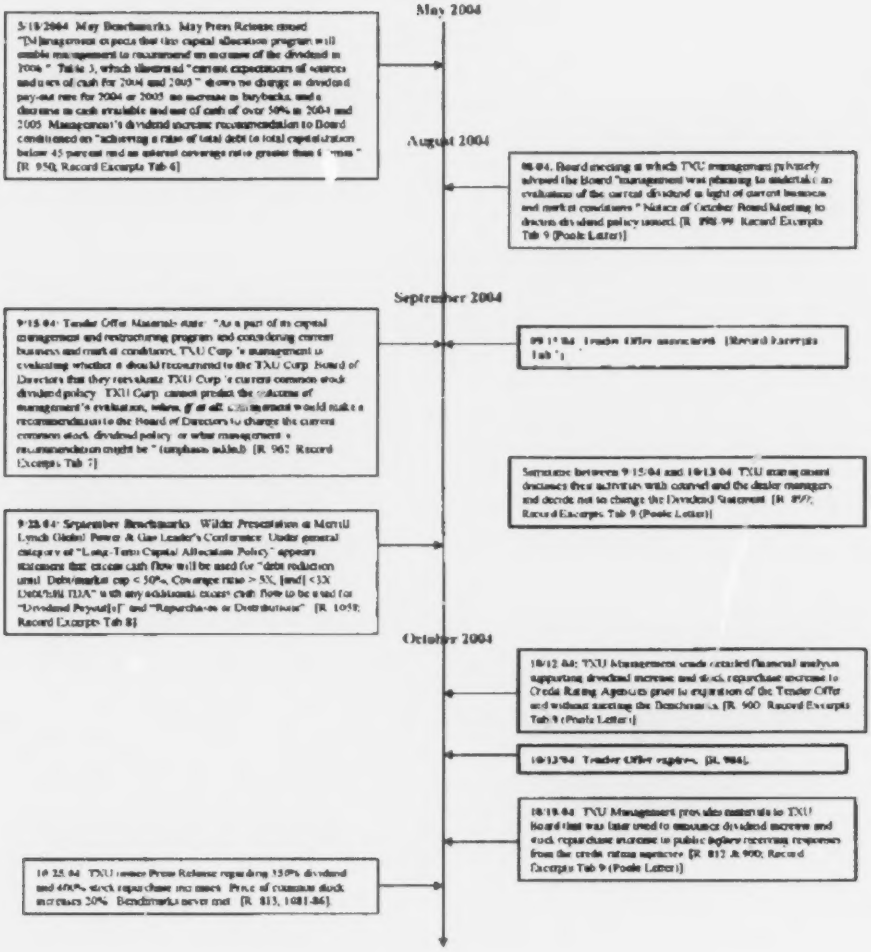
We hope that the information we have shared with you about the timing and process of our decision-making about the dividend increase confirms the appropriateness of the disclosures in connection with the tender, if however you have further questions regarding this matter, please let me know.

Sincerely,

/s/ David P. Poole
DAVID P. POOLE

APPENDIX J

TXU TIMELINE



BEST AVAILABLE COPY

APPENDIX K

News Release [LOGO]

TXU ANNOUNCES HIGHLIGHTS
OF 90-DAY REVIEW

Substantial corporate commitment to improve customer service and reliability

---

Management to provide detail on strategic plans; outlook for 2005 performance

---

Announcement of organizational realignment and new executive team

Highlights:

- **Investor conference to focus on: (i) Initiatives to improve customer service, electric delivery and production reliability, and operational performance; (ii) transactions to improve competitiveness, reduce risk, and build businesses; (iii) Initiatives to Improve 2005 and 2006 financial performance, reduce debt to improve financial flexibility, and generate more earnings and cash**
- **Formation of Capgemini Energy L.P. partnership that will enable TXU to provide better customer service, improve TXU's competitiveness to serve new and existing customers in South Texas, and reduce operating costs**
- **Entry into a memorandum of understanding with Credit Suisse First Boston to invest in an independent national energy trading entity, which is expected to be**

operational in early fall 2004; the to-be-named entity is expected to improve TXU's ability to manage commodity price risks

- **Intent to review strategic options for Comanche Peak nuclear power generation plant to create efficiencies, minimize financial exposure, and to improve certainty of electricity supply**
- **Guidance for income from continuing operations for 2005 of $3.82 to $4.32 per share, an increase of 171 percent over the 2004 guidance midpoint; guidance for operational earnings[1] for 2005 of $3.75 to $4.25 per share, an increase of 60 percent over the 2004 guidance midpoint**
- **Announcement of streamlined organization and the new executive management team**

DALLAS—May 18, 2004—TXU Corp. (NYSE: TXU) provided a preview of its investor conference to be held with institutional investors and financial analysts later today. The conference will review the business plan developed by the company over the past 90 days and include discussions of (i) initiatives to improve customer service, reliability, and operational performance; (ii) transactions to unlock value and reduce risk; (iii) the initial 2005 detailed outlook and high level 2006 outlook; and (iv) announcement of organizational realignment and the new executive management team.

In addition, TXU announces that it will form a limited partnership with a subsidiary of Capgemini America Inc. The limited partnership will be called

---

[1] A non-GAAP measure adjusting for special items. See Attachment 1: Financial Definitions.

Capgemini Energy L.P. and will provide information technology, customer support, billing, and other technology-enabled services to TXU, with the objective of providing information technology and business process services to third parties in the future. TXU also announces it has entered into a memorandum of understanding with respect to working on a 50/50 investment with Credit Suisse First Boston in an energy marketing and trading entity. Finally, TXU announces its intent to review possible strategic options for the Comanche Peak nuclear power generation plant, with the objective of improving the long-term certainty of electricity supply for TXU's customers.

Based on the achievement of the business improvement initiatives, the successful completion of the announced transactions, and the current outlook for commodity prices, TXU estimates that operational earnings for full year 2005 will range from $3.75 to $4.25 per share, an increase of 60 percent relative to 2004, and that income from continuing operations for the full year 2005 will range from $3.82 to $4.32 per share.

"We are committed to improving customer service, reliability and safety, and we are targeting industry-leading performance levels," commented John Wilder, TXU's chief executive officer. "We are excited about these initiatives and the other improvements identified in our 90-day plan, which we will review during the investor conference."

Initiatives to Improve Customer Service, Electric Delivery and Production Reliability, and Operational Performance

As part of the overall business review that TXU conducted over the past 90 days, the company assessed

areas where it should invest to improve customer service, reliability, and safety. With the results of the review, the company is implementing a number of improvements in these areas. In providing service to its residential and business customers, TXU is committed to improving performance after falling short of desired service levels in 2003. The company is forming a partnership with Capgemini that will provide, among other services, call center and billing services to TXU's customers. The related service agreement commits to achieving call answering times of 15 seconds or less, which would match the best service in the industry. The agreement also commits to reducing billing delays by 65 percent and improving customer call satisfaction rates by 30 percent. These improvements are to be achieved through multiple initiatives, including an approximate $100 million investment by Capgemini to the partnership for state-of-the-art processes and technology.

As part of TXU's broad set of customer and community initiatives, the company is committing to a fourfold increase in funding for customers who are in critical and temporary need of assistance in paying their electric bills, setting aside $15 million over the next three years. This is in addition to TXU's weatherization assistance to low income customers of approximately $30 million over the next three years. Helping critical need customers with temporary assistance and education on how to reduce their energy use through efficiency and weatherization is particularly important given today's high natural gas and electricity prices.

In TXU's electric delivery business, the company is undertaking several initiatives to improve network reliability. The company expects to invest $45 million

over the next three years to significantly improve vegetation management across the electric distribution network. This program represents a 70 percent increase over the last three years and will help to ensure that vegetation management returns to an optimum maintenance cycle by 2007. TXU's electric delivery business will also invest on average an extra $80 million annually over the next three years on key transmission projects to further improve reliability and reduce congestion. This represents a 35 percent increase over 2003 investment levels.

In addition, the electric delivery business will invest in capital projects to reduce duration and frequency of outages by a target of 20 percent by 2006. In order to support these programs and build the financial strength of the utility, the company plans to suspend distributions from the electric delivery business to TXU Corp. through 2006. Overall, the investment program is geared toward an objective of achieving top quartile performance in all key utility reliability metrics (SAIDI, SAIFI, and CAIDI) by 2006.

In TXU's power generation business, named TXU Power, the company is also investing in the reliability and performance of its plant assets. Over the next three years, the company will invest an additional $275 milion, increasing annual spending by over 45 percent relative to 2003, to improve the reliability of coal and nuclear production assets to ensure availability of supply for TXU's electricity customers. Consistent with industry practice, the company will also replace the four steam generators in one of the two units of the Comanche Peak nuclear plant in order to maintain the operating efficiency of the unit. Estimated capital requirements for this project, including

purchase and installation, are $175 million to $225 million.

TXU's 90-day business review also included a broad assessment of current operational performance and the identification of priority improvement initiatives. These will span TXU's businesses and will contribute to the financial performance outlook that is described below. Areas of focus include the Capgemini Energy partnership, customer retention in North Texas, more targeted and efficient marketing in South Texas, operational improvements in the power generation and electric delivery businesses, a strategic sourcing program to reduce spending on third-party supplies and services, and productivity improvements through a restructured corporate center.

Transactions to Unlock Value and Reduce Risk

Today TXU announces an additional set of initiatives that will enable the company to advance further against its strategic priorities:

Capgeminl Energy Partnership

TXU has agreed to enter a limited partnership with Capgemini to form Capgemini Energy L.P, a new company that will initially provide business process services and information technology solutions to TXU, with a plan to offer similar services to other energy companies. Under the 10 year agreement, roughly 2,700 employees will move from TXU to Capgemini Energy, effective July 1, 2004. Employees in the new Capgemini Energy partnership will provide information technology, call center, billing, human resources, supply chain and accounts payable, and finance and accounting services to TXU and other energy companies. TXU will own less than 3 percent of Capgemini Energy and has the right to

sell all its interest in the joint venture to Capgemini upon termination of the contract.

Chell Smith, Capgemini Americas Chief Executive Officer stated, "Our new partnership with TXU, Capgemini Energy LP. is one of the top priorities for Capgemini globally. We intend to make a significant investment of millions of dollars to substantially improve the customer service experience for TXU's customers and to help TXU become more competitive. This is a great example of helping clients like TXU implement their growth strategy, leverage technology, and thrive through the power of collaboration."

The company expects the partnership to contribute to better service, improved competitiveness, and reduced operating costs. Under the terms of its agreement with the partnership, Capgemini Energy is committed to achieving 15 second answer times on electric customer calls and to improving customer call satisfaction rates by 30 percent. While enabling these service level improvements, Capgemini Energy will enable TXU to realize significant operational cost savings—achieving $175 million in annual operating cost savings, $140 million in cash savings, in 2005 relative to 2003 levels.

Going forward, Capgemini Energy will serve as Capgemini's exclusive vehicle for offering technology and business process services for other companies in the U.S. electric, gas and water utility industry.

Investment In New Trading Entity

TXU and Credit Suisse First Boston (CSFB) have entered into a memorandum of understanding to work together on a 50/50 investment in an entity that would become the exclusive energy marketing and trading vehicle for both parties in North America.

The transaction will effectively create an Aa3/A+ rated entity through a guarantee from a CSFB company and will combine the benefits of TXU's personnel and their understanding of the energy markets and TXU's significant volumes in Texas, the largest deregulated electricity market in the U.S., with CSFB's preeminent energy banking franchise, structuring skills, credit strength and marketing and risk distribution channels. The entity will market and trade power, natural gas and other energy-related commodities in North America, James Healy, CSFB's Global Co-Head of Fixed Income stated, "Our proposed new investment with TXU fulfills one of the top priorities for CSFB, which is in enter the energy commodities trading markets with a top flight physical energy producer. We are very excited about building this business with TXU, with our mutual goal for this new entity to become a leader in the industry."

While establishing a potential growth platform, the new entity would also allow TXU to achieve one of its strategic priorities—reducing risk—by limiting TXU's aggregate exposure to the marketing and trading business. TXU will be working with CSFB to finalize definitive documentation for the new entity over the coming months, with a goal of beginning operations early this fall.

Strategic Review of Nuclear Assets

TXU also announced its intent to undertake a strategic review of its nuclear assets, which are comprised of two electricity generation units at Comanche Peak, each with a capacity of 1,150 MW. TXU has retained JP Morgan Securities Inc. as an advisor in this strategic review. The objectives of this strategic review are to evaluate potential means to improve

the long term availability and certainty of electricity supply for TXU's customers. TXU is exploring ways to maintain access to firm power supply from a creditworthy counterparty regardless of the operational status of Comanche Peak. Such transformation has been a common practice of utilities that compete in states that have experienced deregulation and restructuring.

Consolidation of Real Estate

As part of the TXU's 90-day business review, the company assessed its real estate needs and opportunities to consolidate office space and enhance the physical working environment. Currently, TXU owns or leases more than 1.7 million square feet in various corporate and headquarters locations, far more than its expected needs, which are approximately 20 percent of that total. To create a more effective physical layout and improve operating and capital efficiency, TXU will explore all alternatives to reduce current office space and consolidate into a location that will enable better employee communication and collaboration.

Initial 2005 Financial Outlook

TXU management expects 2005 operational earnings to be in the range of $3.75 to $4.25 per share, an increase of 60 percent over the 2004 midpoint. Income from continuing operations is projected to be between $3.82 and $4.32 per share for 2005, an increase of 171 percent over the 2004 midpoint. Management expects 2006 operational earnings to improve by 10-13 percent relative to 2005.

Table 1: Operational Earnings Outlook summarizes the cumulative impact of business improvement initiatives, transactions, and the liability management program on operational earnings.

Table 1: Operational Earnings Outlook
$ per diluted share

	03 Actual	04 Estimate	05 Estimate
03 income from continuing operations	2.09		
Preference dividends	0.06		
03 actual operational earnings	2.03		
Discontinued operations (TXU Australia, TXU Gas)[1]	(0.44)		
Operational earnings after transactions	1.59		
Electric delivery	0.68	0.75	0.98
TXU Power[2]	1.27	1.90	1.93
TXU Energy[2]	0.28	0.53	1.28
Hedge losses[3]	(0.24)	(0.27)	(0.25)
Corporate[4]	(0.40)	(0.40)	0.03
Operational earnings – after business improvement	1.59	2.50	4.00
Operational earnings range		2.45 – 2.55	3.75 – 4.25
Special items	-	1.07	-
Preference dividends	0.06	0.07	0.07
Income from continuing operations – after business improvement	1.65	1.43 – 1.53	3.82 – 4.32
Weighted average diluted shares outstanding (millions)	379	337	317

[2] Includes impact of inter-company interest

[3] TXU Power includes addition of $52 million after tax of distributions and discount on preferred membership interests to adjust for diluted share calculation. TXU Power and TXU Energy 2003 amounts are proforma, and TXU Energy reported results would include hedging losses.

[4] Includes dilution adjustment of $52 million ($0.14 per share) in 2003 and $18 million ($0.05 per share) in 2004, representing distributions and amortization of discount on TXU Energy exchangeable preferred membership interests, after tax.

As part of the execution of the 90-day review initiatives, the company expects to incur a number of special items, including $70 million (after tax) related to employee severance and related costs as shown in Table 2: Description of Projected Special Items.

Table 2: Description of projected Special Items 04; $ millions after tax

Special Item	Income Statement Impact
Other deductions - software write-off	90
Other deductions – debt reacquisition costs	75
Other deductions - mine and gas plant closures	75
Other deductions and SG&A - severance and other compensation costs	70
Other deductions - inventory write-down	50
Total	360

Liability Management

TXU continues to pursue a comprehensive liability management program geared toward increasing value and reducing risks. The liability management program includes several actions, including the recent repurchase of approximately $423 million principal amount of equity-linked securities or common equity units ("CEUs"), thereby reducing debt, eliminating the potential issuance of 9.3 million common shares, and settling a related lawsuit, TXU plans to repurchase over $4 billion of debt, equity, and/or equity-linked securities in 2004, and an additional $800 million to $900 million of debt, equity, and/or equity-linked securities in 2005.

Capital Allocation

During the investor conference, management will also define in further detail the company's ongoing capital allocation strategy. The first priority for the use of free cash flow will be for investments to preserve and enhance the quality of customer service and production and delivery reliability. The company will then consider reinvestments in its businesses, applying stringent expectations for cash payback timelines and minimum returns on investment. Remaining free cash flow will be used to reduce debt and other liabilities, with the objective of achieving a ratio of total debt to total capitalization below 45 percent and an interest coverage ratio greater than 6 times.

Upon reaching the targeted balance sheet strength and financial flexibility, management would recommend that the Board of Directors reevaluate the current dividend policy. At that time, management expects it would recommend targeting annual com-

mon stock dividends equal to a pay out of 100 percent of the earnings of TXU's electric delivery business. Of the free cash flow, management would expect to return roughly 80 percent to shareholders in the form of distributions or repurchases and to retain roughly 20 percent for long term growth initiatives. Assuming the execution of the business initiatives and transactions described above, and depending on market trends in commodity prices, management expects that this capital allocation program will enable management to recommend an increase of the dividend in 2006. In addition to management's recommendation, the Board of Directors may consider other relevant factors in determining if and when to make a change in the dividend policy.

Table 3: Source and uses of cash provides current expectations of sources and uses of cash for 2004 and 2005

Table 3: Sources and Uses of Cash
04 and 05 Estimates: 5million

	04E	05E
Sources:		
Cash flow from operations	1,400	1950
Divestment of assets[5]	3,360	-
Use of cash/restricted cash	1,115	100
Total sources	5,875	2,050
Uses:		
Capital expenditures	1,050	975
Reinvestment opportunities	TBD	TBD
Debt/equity repurchase net of issuances (including premiums/discounts)	4,640	890
Dividends	185	185
Total Uses	5,875	2,050

[5] Does not include $2.15 billion of debt to be assumed by counterparties.

Organizational Realignment and New Executive Management Announced

TXU also named the executive management team that will run the company. TXU will be operated

along three core business segments consisting of TXU's regulated electric delivery business, and its unregulated businesses, TXU Power and TXU Energy. As part of the realignment, TXU Energy will form an advisory committee to represent the interests of various stakeholders in the markets it serves.

Tom Baker, previously president of TXU Energy, will assume the position of chairman and chief executive of the company's regulated electric delivery business. Mika Greene, previously president of Oncor, will assume the position of chairman and chief executive of TXU Power, with responsibility for TXU's power production assets. Paul O'Malley will assume the position of chairman and chief executive of TXU Energy, the company's retail energy business.

In addition to the leadership of the company's three core businesses, three other key leadership roles were announced. Kirk Oliver, most recently senior vice president and treasurer for TXU, will assume the position of executive vice president and chief financial officer; Eric Peterson will continue as executive vice president and general counsel, with the added responsibility for governmental and regulatory affairs; and David Campbell, formerly of McKinsey & Company, Inc., will assume the post of executive vice president of corporate planning, strategy and risk.

These appointments are expected to be confirmed by the Board of Directors this week.

TXU also announced that Dan Farell, previously chief financial officer, will play a vital role in overseeing TXU's interface with Capgemini Energy and the transition to the new partnership.

Investor Conference

TXU's senior management team will present its new business plans to institutional investors and financial analysts at an investor conference today at the Gaylord Texan Resort and Convention Center Hotel in Grapevine, Texas. The event will be webcast live at www.txucorp.com. The conference will begin at 8:00 am CDT with an update by John Wilder on the transactions announced today as well as the company's long term strategic plan. The leadership team will then make subsequent presentations. Slide presentations and other information to be provided at the conference will be available on TXU's website in the Investor Resources section.

Forward Calendar

Table 4: Milestones represents a summary of the key events and milestones over the coming months.

Table 4: Milestones

04; Dates

Milestone	Expected Timing
Present strategic plan at investor conference	May 18
Target close date for TXU Fuel Company	June 1
Target close date for Capgemini Energy partnership	July 1
Expected approval date for 2nd PTB filing	By July 10
Target close date for TXU Australia	July 30
Target close date for Trading joint venture	September 30
Target close date for TXU Gas divestment	By December 31

TXU, a Dallas-based energy company manages a portfolio of competitive and regulated energy businesses in North America, primarily in Texas. In TXU's unregulated business, TXU Energy provides electricity and related services to more than 2.6 million competitive electricity customers in Texas, more customers than any other retail electric provider in the state. TXU Power owns and operates 18,500 megawatts of generation in Texas, including 2,300

MW of nuclear-fired and 5,837 MW of lignite/coal-fired generation capacity. The company is also the largest purchaser of wind-generated electricity in Texas and among the top five purchasers in the North America. TXU's regulated electric distribution and transmission business complements the competitive operations, using asset management skills developed over more than one hundred years, to provide reliable electricity delivery to consumers. TXU's electric delivery operations are the largest in Texas, providing power to 2.9 million delivery points over more than 98,000 miles of distribution and 14,000 miles of transmission lines. TXU has agreed to sell its energy business in Australia, TXU Australia, and has announced its intent to sell TXU Gas, its largely regulated natural gas transmission and distribution business in Texas. Visit www.txucorp.com for more information about TXU.

This release contains forward-looking statements, which are subject to various risks and uncertainties. Discussion of risks and uncertainties that could cause actual results to differ materially from management's current projections, forecasts, estimates and expectations is contained in the company's SEC filings. In addition to the risks and uncertainties set forth in the company's SEC filings, the forward-looking statements in this release could be affected by the ability of purchasers to obtain all necessary governmental and other approvals and consents for the acquisition of TXU Australia and TXU Fuel and the ability of the company to exit the business of TXU Gas, finalize the energy marketing and trading joint venture, achieve the cost reductions from the Capgemini Energy partnership and to implement the other initiatives that are part of the 90-day business review, and the terms

under which the company executes those transaction or initiatives.

—END—

Investor Relations:

Tim Hogan	Laura Coen	Rose Blessing
214-812-4641	214-812-3127	214-812-2498

Media:

Joan Hunter	Carol Peters	Chris Schein
214-812-4071	214-812-5924	214-812-5338

Attachment 1: Financial Definitions

Reported Earnings Per Share (EPS) (GAAP measure): Per share (diluted) net income available to common shareholders. When calculating diluted earnings per share, net income is adjusted for the after-tax interest on the securities creating the dilution (exchangeable preferred membership interests).

Operational Earnings Per Share (a non-GAAP measure): Per share (diluted) income from continuing operations, excluding special items and net of preference share dividends. Management believes that operational earnings is a useful measure of underlying results because of the magnitude and scope of the initiatives developed in the 90-day review (the "4+4" program) and the significant effect of the special items on reported results. Management relies on operational earnings for evaluation of performance and believes that analysis of the business by external users is enhanced by visibility to both reported GAAP earnings and operational earnings.

Income from Continuing Operations: Income from continuing operations before extraordinary items and

cumulative effect of changes in accounting principles — per income statement (a GAAP measure).

Special Items: Unusual charges related to the implementation of the 4+4-performance improvement program and other charges, credits or gains that are unusual or nonrecurring, including debt reacquisition costs resulting from use of proceeds from divestments to reduce debt. The 4+4 program is being implemented in phases, and the charges are expected to occur largely within a one-year period. Special items are included in reported GAAP earnings, but are excluded from operational earrings. Special items associated with the 4+4 program will include costs related to severance programs, asset impairments and facility closures.

Free Cash Flow (a non-GAAP measure):
Cash Provided by Operating Activities
Less Changes in Assets and Liabilities
Less Capital Spending
A measure used by management to assess funds available to repay debt and other obligations.

Total Debt (a non-GAAP measure):
Long-term Debt (including current portion)
Plus Bank Loans and Commercial Paper
Plus Long Term Debt Held by Subsidiary Trusts
Plus Preferred Securities of Subsidiaries & Exchangeable Preferred Member Interests
Less Securitization Bonds
Total debt is a measure used by management to reflect the off credit treatment of the securitization bonds in credit reviews.

Total Debt / Total Capitalization
Total Debt (as defined above)/ Total Capitalization

Total Capitalization: Total Debt plus Shareholders Equity.

Interest Coverage (a non-GAAP measure): Income front Continuing Operations before Interest and Related Charges, Income Taxes, and Depreciation and Amortization, all per income statement, divided by Interest Expense and Related Charges. Interest coverage is a measure used by management to assess credit quality.

Attachment 2: Description of Counterparties and Affected TXU Businesses

Counterparties

About Capgemini

Capgemini, one of the world's foremost providers of Consulting, Technology and Outsourcing services, has a unique way of working with its clients through the Collaborative Business Experience™. Through commitment to mutual success and the achievement of tangible value, the company helps businesses implement growth strategies, leverage technology and thrive through the power of collaboration. The Collaborative Business Experience™ has helped businesses worldwide for over three decades in achieving measurably faster, more sustainable results. Capgemini employs approximately 55,000 people worldwide. More information about individual service lines, offices and research is available at www.capgemini.com

About Credit Suisse first Boston

Credit Suisse First Boston (CSFB) is a leading global investment bank serving institutional, corporate, government and individual clients. CSFB's businesses include securities underwriting, sales and

trading, investment banking, private equity, financial advisory services, investment research, venture capital, correspondent brokerage services and asset management. CSFB operates in 69 locations in 34 countries across five continents. The Firm is a business unit of the Zurich-based Credit Suisse Group, a leading global financial services company.

TXU Businesses and Assets Discussed in this Release

Business Services

TXU Business Services is a provider of certain information technology, human resources, procurement, finance, accounting, real estate and tax management services, and other services at cost, to TXU Corp. and its other subsidiaries.

Portfolio Management

TXU's portfolio management or trading business unit optimizes assets, which includes scheduling and dispatching TXU's generation capacity and securing third party load supply for the retail business. Portfolio Management manages the commodity risk exposure of the company on both a short-term and long-term basis. The origination function within Portfolio Management creates structured products for customers with either off-take agreements or power supply agreements.

Comanche Peak

Comanche Peak Nuclear Steam Electric Station is comprised of two nuclear-fueled electricity generating units with a total capacity of 2,300 MW. Units 1 and 2 were placed into commercial operation in 1990 and 1992, respectively. It is estimated that the useful life of the Comanche Peak units is 60 years.

(2)

No. 09-2

Supreme Court, U.S.
FILED
AUG 28 2009
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED, et al.,

Petitioners,

v.

TXU CORP., et al.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF IN OPPOSITION

GERARD G. PECHT*
RICHARD S. KRUMHOLZ
FULBRIGHT & JAWORSKI L.L.P.
2200 Ross Avenue, Suite 2800
Dallas, Texas 75201
(214) 855-8050

PETER A. STOKES
FULBRIGHT & JAWORSKI L.L.P.
600 Congress, Suite 2400
Austin, Texas 78701
(512) 536-5287

* *Counsel of Record* *Counsel for Respondents*

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTION PRESENTED

Whether the Court of Appeals correctly applied the well-settled pleading requirements for fraudulent intent under the Private Securities Litigation Reform Act and Federal Rules of Civil Procedure 8 and 9(b) to the particular facts in this case in affirming the dismissal of petitioners' complaint.

RULE 29.6 STATEMENT

TXU Corp. is now known as Energy Future Holdings Corp.. Energy Future Holdings Corp. has no parent corporation, and no publicly held company owns 10% or more of its stock.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

RULE 29.6 STATEMENT ii

INTRODUCTION 1

COUNTERSTATEMENT 4

A. The Factual Allegations 4

B. The Decisions Below 8

REASONS FOR DENYING THE PETITION 10

I. THE PETITION IDENTIFIES NO EXISTING CIRCUIT SPLIT OR UNSETTLED QUESTION OF LAW 10

A. There Is No Circuit Split Or Unsettled Question of Law Regarding The Applicable Pleading Standards. 10

1. *Twombly* and *Iqbal* Definitively Resolve The Issue 11

2. Petitioners' Alleged Circuit Split Is Illusory. 12

B. There Is No Circuit Split Or Unsettled Question Of Law Regarding The Pleading Standards For Section 14(e) Claims. 16

II. THIS CASE INVOLVES THE CORRECT APPLICATION OF SETTLED LAW 19

TABLE OF CONTENTS

Page

A. The Fifth Circuit Applied The Same Standard As *Twombly* And *Iqbal* 19

B. The Allegations Fail To Support A Plausible Inference Of Fraud As Required By Rule 8. 20

C. The Fifth Circuit Did Not Engage In Impermissible Fact-Finding. 266

III. THIS CASE PROVIDES AN UNSUITABLE VEHICLE FOR REVIEWING THE QUESTIONS PRESENTED 28

CONCLUSION 31

TABLE OF AUTHORITIES

Page

CASES:

Am. Realty Trust, Inc. v. *Hamilton Lane Advisors, Inc.*, 115 Fed. Appx. 662 (5th Cir. 2004) 15

Anderson v. *Sara Lee Corp.*, 508 F.3d 181 (4th Cir. 2007) 13

Ashcroft v. *Iqbal*, 129 S. Ct. 1937 (2009) .... *passim*

Bell Atl. Corp. v. *Twombly*, 550 U.S. 544 (2007) ..... *passim*

Berman v. *Gerber Prods. Co.*, 454 F. Supp. 1310 (W.D. Mich. 1978) 26

Chromalloy Am. Corp. v. *Sun Chem. Corp.*, 611 F.2d 240 (8th Cir. 1979) 26

Conn. Nat'l Bank v. *Fluor Corp.*, 808 F.2d 957 (2d Cir. 1987) 17

Cozzarelli v. *Inspire Pharm. Inc.*, 549 F.3d 618 (4th Cir. 2008) 25

In re Digital Island Secs. Litig., 223 F. Supp. 546 (D. Del. 2002), *aff'd*, 357 F.3d 322 (3d Cir. 2004) 17, 24

DiLeo v. *Ernst & Young*, 901 F.2d 624 (7th Cir. 1990) 16

Dorsey v. *Portfolio Equities, Inc.*, 540 F.3d 333 (5th Cir. 2008) 15

Eternity Global Master Fund Ltd. v. *Morgan Guar. Trust Co. of N.Y.*, 375 F.3d 168 (2d Cir. 2004) 16

Fecht v. *Price Co.*, 70 F.3d 1078 (9th Cir. 1995) 18

TABLE OF AUTHORITIES—Continued

	Page(s)
Feder v. *MacFadden Holdings, Inc.*, 698 F. Supp. 47 (S.D.N.Y. 1988)	26
Flaherty & Crumrine Preferred Income Fund Inc. v. *TXU Corp.*, No. 3:05-CV-1784-G, 2006 WL 2583212 (N.D. Tex. Aug. 30, 2006)	8
Flaherty & Crumrine Preferred Income Fund Inc. v. *TXU Corp.*, 242 Fed. Appx. 253 (5th Cir. Sept. 18, 2007)	8
Gross v. *Summa Four, Inc.*, 93 F.3d 987 (1st Cir. 1996)	24
GSC Partners CDO Fund v. *Washington*, 368 F.3d 228 (3d Cir. 2004)	25
Halperin v. *eBanker USA.com, Inc.*, 295 F.3d 352 (2d Cir. 2002)	18
Hecker v. *Deere & Co.*, 556 F.3d 575 (7th Cir. 2009)	13
Hefferman v. *Bass*, 467 F.3d 596 (7th Cir. 2006)	13
In re Burlington Coat Factory Secs. Litig., 114 F.3d 1410 (3d Cir. 1997)	16
In re Navarre Corp., 299 F.3d 735 (8th Cir. 2002)	14
Institutional Investors Group v. *Avaya, Inc.*, 564 F.3d 242 (3d Cir. 2009)	25
K-Tel Int'l Inc. Sec. Litig. v. *K-Tel Int'l Inc.*, 300 F.3d 881 (8th Cir. 2002)	16
Kalint v. *Eichler*, 264 F.3d 131 (2d Cir. 2001)	25

TABLE OF AUTHORITIES—Continued

	Page(s)
Lormand v. *US Unwired, Inc.*, 565 F.3d 228 (5th Cir. 2009)	10, 18
Mo. Portland Cement Co. v. *H.K. Porter Co.*, 535 F.2d 388 (8th Cir. 1976)	26
Morganroth & Morganroth v. *Norris, McLaughlin & Marcus, P.C.*, 331 F.3d 406 (3d Cir. 2003)	14
North Am. Catholic Educ. Programming Found. Inc. v. *Cardinale*, 567 F.3d 8 (1st Cir. 2009)	15-16
Plotkin v. *IP Axess Inc.*, 407 F.3d 690 (5th Cir. 2006)	23
Reiss v. *Pan Am. World Airways*, 711 F.2d 11 (2d Cir. 1983)	26
S.E.C. v. *Ginsburg*, 362 F.3d 1292 (11th Cir. 2004)	17
Shamrock Holdings, Inc. v. *Polaroid Corp.*, 709 F. Supp. 1311 (D. Del. 1989)	26
Shaw v. *Digital Equip. Corp.*, 82 F.3d 1194 (1st. Cir. 1996)	18
Susquehanna Corp. v. *Pan Am. Sulphur Co.*, 423 F.2d 1075 (5th Cir. 1970)	26
Taylor v. *First Union Corp. of S.C.*, 857 F.2d 240 (4th Cir. 1988)	26
Tellabs, Inc. v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007)	*passim*
Todd Shipyards Corp. v. *Madison Fund, Inc.*, 547 F. Supp. 1383 (S.D.N.Y. 1982)	26

TABLE OF AUTHORITIES—Continued

	Page(s)
Warner Commc'ns, Inc. v. *Murdoch*, 581 F. Supp. 1482 (D. Del. 1984)	26
West Coast Roofing & Waterproofing, Inc. v. *Johns Manville, Inc.*, 287 Fed. Appx. 81 (11th Cir. 2008)	14
Wight v. *BankAmerica Corp.*, 219 F.3d 79 (2d Cir. 2000)	14
U.S. ex rel. SNAPP, Inc. v. *Ford Motor Co.*, 532 F.3d 496 (6th Cir. 2008)	12-13
U.S. ex rel. Willard v. *United Health Plan of Tex. Inc.*, 336 F.3d 375 (5th Cir. 2003)	15
U.S. ex rel. Wilson v. *Kellogg Brown & Root, Inc.*, 525 F.3d 370 (4th Cir. 2008)	15
Yourish v. *Cal. Amplifier*, 191 F.3d 983 (9th Cir. 1999)	24

STATUTE:

15 U.S.C. § 78n(e)	3

RULES:

Fed. R. Civ. P. 8	*passim*
Fed. R. Civ. P. 9(b)	*passim*
Fed. R. Civ. P. 12(b)(6)	27

OTHER AUTHORITY:

Notice Pleading Restoration Act of 2009, S. 1504, 111th Cong. (2009)	29

IN THE

Supreme Court of the United States

No. 09-2

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED, et al.,

Petitioners,

v.

TXU CORP., et al.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF IN OPPOSITION

INTRODUCTION

Respondents TXU Corp. (now known as Energy Future Holdings Corp.) ("TXU") and C. John Wilder ("Wilder") oppose the petition for certiorari because, among other reasons, the Court of Appeals' decision (1) does not raise any novel or disputed issues of law; (2) involves a correct application of settled law to what petitioners concede are "unique" factual circumstances; and (3) presents an inappropriate, ill-timed, and highly fact-specific vehicle for addressing the questions presented.

The petition identifies no disputed legal question warranting certiorari. In unanimously affirming

dismissal of petitioners' claims, the Fifth Circuit correctly applied the Private Securities Litigation Reform Act ("PSLRA") and Federal Rules of Civil Procedure 8 and 9(b) to the particular facts of this case in determining that the complaint failed to allege a sufficient inference of fraudulent intent. The petition raises no salient question of law not fully addressed in this Court's recent opinions in *Bell Atl. Corp.* v. *Twombly*, 550 U.S. 544 (2007) and *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007). Indeed, *Ashcroft* v. *Iqbal*, 129 S. Ct. 1937 (2009), puts to rest any notion that the Fifth Circuit applied an incorrect pleading standard. Petitioners do not and cannot explain how the Fifth Circuit's standard for pleading fraudulent intent under Rules 8 and 9(b), which requires "'particularized facts supporting an inference of fraud,'" Pet. App. 22a (citation omitted), differs from the standard articulated in *Twombly* and *Iqbal* that a complaint's factual allegations must support a plausible inference of the required state of mind.

Iqbal also forecloses petitioners' Rule 9(b) "circuit split" argument by squarely holding, in full accord with the Fifth Circuit's decision, that conclusory assertions of scienter are insufficient. In any event, petitioners mischaracterize the circuits' application of Rule 9(b) and overlook decisions from other circuits that are fully consistent with the approach taken by the Fifth Circuit and this Court.

Petitioners' suggestion that the Fifth Circuit applies a different pleading standard to "business fraud" cases likewise rings hollow. The petition does not and cannot cite a single Fifth Circuit decision applying a different or more lenient standard in cases not involving "business fraud." To the contrary,

the Fifth Circuit has consistently applied the pleading standards under the Federal Rules of Civil Procedure and the PSLRA.

Nor does this case merit special attention merely because it involves a "self-tender" offer under the Williams Act. Petitioners fail to identify any circuit split or nationwide controversy over the pleading standard for private civil claims under the Williams Act provision at issue, 15 U.S.C. § 78n(e) ("Section 14(e)"). To the contrary, courts addressing Section 14(e) have uniformly held that plaintiffs must plead and prove scienter to the same extent as under Section 10(b) and Rule 10b-5. All such claims are governed by *Tellabs*, a decision the Fifth Circuit faithfully applied.

In the end, the petition devolves into a garden-variety protest that the appellate court incorrectly weighed the inferences from petitioners' factual allegations. Petitioners' argument that the Fifth Circuit "misweighed" the inferences fails. As petitioners concede, TXU expressly disclosed that it was reviewing its dividend and stock-repurchase policies during the tender offer. Everything TXU stands accused of doing is consistent with that disclosure. But in any event, as petitioners also repeatedly concede, the fact pattern of this case is "unique." Pet. 6, 7, 8. There is no reason why this unique context-specific fact pattern, which is merely one of many possible permutations and combinations of facts that may arise in securities fraud cases, merits further review. The applicable pleading standards have already been addressed by this Court several times during the past three years, and any decision with respect to this case would necessarily

be limited to its facts and would offer little precedential value or guidance for future cases.

It is little wonder why this case was dismissed twice in the district court and affirmed unanimously on appeal. The petition should be denied.

COUNTERSTATEMENT

A. The Factual Allegations

This is a federal and state law fraud action against TXU and its former CEO, Wilder. Petitioners voluntarily sold their convertible TXU debt securities to TXU in October 2004 through a tender offer in which they received a substantial premium over the then-current market price of the securities. Despite the considerable returns petitioners reaped on their investment in TXU, petitioners complain that they would have profited even more had they declined the tender offer and retained their TXU securities, which rose in value when TXU announced a dividend increase and stock repurchase.

Petitioners assert that TXU and Wilder acted with intent to defraud or severe recklessness when they allegedly misrepresented or failed to disclose during the tender offer whether those future events would occur. Petitioners, however, allege no facts demonstrating that TXU knew with certainty *before* the close of the tender offer that its management would recommend a dividend increase or change in the stock repurchase plan to TXU's Board of Directors at any particular time, let alone that TXU's Board would approve either one.

Instead, as demonstrated by petitioners' own factual allegations, TXU expressly disclosed that it was reviewing the policies at issue:

- TXU disclosed on May 18, 2004, four months before the tender offer was made, that "management would recommend that the Board of Directors reevaluate the current dividend policy" after the company met certain financial goals. Pet. App. 63a-64a. TXU further disclosed that the company's capital allocation program "will enable management to recommend an increase of the dividend in 2006." *Id.* The May 18 press release also stated that "the Board of Directors may consider other relevant factors in determining if and when to make a change in the dividend policy." *Id.*
- After substantial improvement in TXU's business over the summer, TXU disclosed on September 15, 2004, at the beginning of the tender offer, that this "evaluation" and "review"—previously estimated to take place in 2006—had already begun and was ongoing. Pet. App. 67a-68a. The September 15 disclosure stated that

> [a]s a part of its capital management and restructuring program and considering current business and market conditions, TXU Corp.'s management is evaluating whether it should recommend to the TXU Corp. Board of Directors that they reevaluate TXU Corp.'s current common stock dividend policy. *TXU Corp. cannot predict the outcome of management's evaluation, when, if at all, management would make a recommendation to the Board of Directors to change the current common stock dividend policy, or what management's recommendation might be.*

> In addition to any recommendation from management, the Board of Directors may consider other relevant factors in determining if and when to make a change in TXU Corp.'s common stock dividend policy.

Id. (emphasis added). This statement was included in a September 15, 2004 press release and Form 8-K, which was filed with the SEC, and was incorporated verbatim into the tender offer document itself. *Id.*

- TXU also disclosed, in a September 28, 2004 presentation by its CEO filed with the SEC before petitioners tendered their securities, that both the dividend and stock-repurchase policies were "[u]nder review," and that TXU was in the process of determining "[h]ow much cash we should return to our shareholders." *See* Pet. App. 70a, 170a.

Contrary to petitioners' contentions, none of these disclosures was "boilerplate." Pet. 21-22. Rather, each was specifically tailored to TXU's particular circumstances at the time it was made.

Despite these express disclosures, petitioners argue that TXU and Wilder committed fraud because the company (i) hired a financial advisor to review the dividend issue; (ii) communicated with credit rating agencies during the tender offer and provided them with detailed information about the dividend policy before the tender offer closed; (iii) provided dividend-related materials to the Board after the tender offer had closed, and scheduled an October 22, 2004 Board meeting to discuss the dividend and stock repurchase issues; and (iv) approved a dividend increase and

stock repurchase during that Board meeting and announced them on October 25, 2004.

But each of these actions is fully consistent with TXU's disclosure that it was "review[ing]" and "evaluat[ing]" its dividend and stock repurchase policies. The complaint pleads no facts demonstrating that TXU management was in a position to recommend a dividend or stock repurchase increase before receiving feedback from the credit rating agencies about the likely impact of such an increase on the company's credit rating, or that the company received such feedback before the tender offer closed.

In fact, far from supporting an inference of fraud, the purported "expert report" attached to petitioners' own complaint undermines petitioners' argument that TXU management knew all along what the credit rating impact of a dividend increase or stock repurchase would be. The report concedes that: (i) credit ratings are highly subjective and "complex," are "predicated on a host of qualitative or judgmental factors," and are "as much an art as * * * a science"; (ii) rating agencies "would have been particularly careful in evaluating companies with only marginally investment grade credit ratings" such as TXU, which had a near-junk rating at the time; (iii) during October 2004, "Moody's was conducting overwhelmingly negative rating actions, reviews, and outlooks in the utilities industry" due to the continued fallout from Enron's collapse; (iv) nearly 30% of companies that increased their dividends by more than 100% from 2000-06 suffered a ratings downgrade; (v) TXU's energy trading business depended on having an investment-grade rating; and (vi) "[a] single notch decline" in TXU's rating would have had "disastrous

effects on the Company * * *." Pet. App. 117a-125a, 142a-143a, 164a.

B. The Decisions Below

Petitioners originally filed this case as a federal class action under Sections 10(b) and 14(e) of the Securities Exchange Act without asserting any state law claims. The district court granted petitioners' initial motion to dismiss on August 30, 2006, holding that the "quantum of facts" alleged by petitioners failed to support a strong inference of scienter, as is required for such claims. *Flaherty & Crumrine Preferred Income Fund Inc.* v. *TXU Corp.*, No. 3:05-CV-1784-G, 2006 WL 2583212, at *6-7 (N.D. Tex. Aug. 30, 2006) (observing that petitioners' allegations "do not plainly invalidate" TXU's disclosures and that "hiring a financial advisor and submitting a financial plan to credit rating agencies appears to substantiate the defendants' disclosure that the dividend policy was under review"). Because this Court decided *Tellabs* while petitioners were pursuing their initial appeal, the Fifth Circuit vacated the district court's first dismissal without consideration of the merits and remanded to give the district court an opportunity to evaluate the allegations under *Tellabs*. *Flaherty & Crumrine Preferred Income Fund Inc.* v. *TXU Corp.*, 242 Fed. Appx. 253 (5th Cir. Sept. 18, 2007).

Following remand, petitioners amended their complaint to add a non-class claim for common law fraud, which they have now made the centerpiece of their petition for certiorari. The amended complaint also included an "expert" report from Professor Linda Allen, a law professor who claimed expertise concerning credit rating agencies. After allowing the amendment, the district court applied *Tellabs* to the

amended complaint and again determined that petitioners failed to state a claim. Pet. App. 27a. As *Tellabs* requires, the district court took petitioners' "well-pleaded facts" as true, evaluated petitioners' allegations "holistically," and compared the overall "quantum of facts" to those in other decisions to determine whether a strong inference of scienter was pled. *Id.* at 36a-46a. The court concluded that "there is hardly more substance to [petitioners'] current claims than in their initial complaint" and that "professor Allen's assessment of the facts does little to establish a strong inference of scienter." *Id.* at 44a & n.11. The court also dismissed the common law fraud claim, holding that the allegations "fail to show *how* each statement was fraudulent." *Id.* at 47a.

The Fifth Circuit unanimously affirmed the district court's second dismissal. Pet. App. 1a. The court observed that "it is not clear that Appellees ever issued a materially misleading statement or omission of fact concerning the dividend policy." *Id.* at 16a. In particular, "the statement that the dividend policy was 'under review' conveyed that TXU had taken some steps in evaluating a change in the dividend policy * * * ." *Id.* at 17a. After "[t]aking into account all of the facts in the aggregate, as well as inferences opposing fraudulent intent," the court held that "Appellants have failed to raise a strong inference that TXU, and specifically Wilder, acted with the intent to deceive, manipulate, or defraud or acted with severe recklessness in making statements concerning the dividend policy." *Id.* at 21a. The court also affirmed dismissal of the common law fraud claim, holding that the allegations "do not suffice to establish an inference of fraud under Rule 9(b)." *Id.* at 23a.

One day after issuing its opinion in this matter, the Fifth Circuit reversed the dismissal of another securities fraud lawsuit involving a different company. *Lormand* v. *US Unwired, Inc.*, 565 F.3d 228 (5th Cir. 2009). As demonstrated by *Lormand* and numerous other cases, the Fifth Circuit is more than willing to sustain pleadings that meet the requirements of the PSLRA and Rule 9(b) depending on the individualized facts of each case. This case, however, fell far short of the applicable pleading requirements and was properly dismissed.

REASONS FOR DENYING THE PETITION

I. THE PETITION IDENTIFIES NO EXISTING CIRCUIT SPLIT OR UNSETTLED QUESTION OF LAW.

Petitioners' two questions presented focus entirely on their common law fraud and Section 14(e) claims and, tellingly, do not address their securities fraud claim under Section 10(b). Because the scienter requirement for Section 10(b) claims was thoroughly addressed in *Tellabs*, it is hardly surprising petitioners struggle to find some other basis for certiorari. Neither of the questions presented, however, provides any reason to accept this case.

A. There Is No Circuit Split Or Unsettled Question Of Law Regarding The Standards For Pleading Intent Under The Federal Rules.

Petitioners first suggest the Court should grant certiorari to address a purported nationwide controversy over the meaning of Rule 9(b)'s prescription that "state of mind" allegations can be "alleged generally." This supposed controversy does not exist and, even if it did, would not be implicated

in this case. *Iqbal* expressly holds, following *Twombly*, that Rule 9(b)'s "alleged generally" language does not relieve parties from the strictures of Rule 8 in pleading the required state of mind. To the extent any prior decisions suggest otherwise, *Twombly* and *Iqbal* clearly control and foreclose petitioners' argument. But in any event, the cases cited in the petition evince no circuit split.

1. Petitioners' Alleged Circuit Split Is Not Implicated Here Because *Twombly* And *Iqbal* Definitively Resolve The Standard For Pleading Intent.

In *Iqbal*, the Court reiterated its prior holding in *Twombly* that even in a "notice pleading" case under Rule 8, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Iqbal*, 129 S. Ct. at 1949 (quoting *Twombly*, 550 U.S. at 570). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (citing *Twombly*, 550 U.S. at 556). "Where a complaint pleads facts that are 'merely consistent with' a defendant's liability, it 'stops short of the line between possibility and plausibility of 'entitlement to relief.'" *Id.* (quoting *Twombly*, 550 U.S. at 557). Determining whether a complaint states a "plausible" claim is "a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." *Id.* at 1950.

Iqbal also specifically addresses the state-of-mind requirement under Rule 9(b), which is the primary ground for certiorari urged here. Much as petitioners have done, the plaintiff in *Iqbal* sought refuge in

Rule 9(b)'s statement that intent may be alleged "generally." *Id.* at 1954. The Court rejected that assertion, holding that Rule 9(b)'s "alleged generally" language "does not give [a plaintiff] license to evade the less rigid—though still operative—strictures of Rule 8," and "does not empower [the plaintiff] to plead the bare elements of his cause of action, affix the label 'general allegation,' and expect his complaint to survive a motion to dismiss." *Id.* Applying the general standard of Rule 8 as elucidated in *Twombly*, the Court held that the respondent's complaint failed to plead sufficient facts to support a plausible inference of discriminatory intent. *Id.*

Accordingly, there can be no circuit split over the pleading requirement for fraudulent intent because this Court has definitively resolved the issue. Under *Twombly* and *Iqbal*, the well-pled factual allegations must support a plausible inference of the required state of mind. Any prior circuit court decisions that can be read as holding otherwise have been superseded by *Twombly* and *Iqbal*.

2. Petitioners' Alleged Circuit Split Is Illusory In Any Event.

Leaving aside this Court's resolution of the standard for pleading intent under the Federal Rules, the various pre-*Iqbal* cases cited on pages 19-21 of the petition as evidence of a purported "circuit split" fail to demonstrate any such controversy. Particularly given the recent guidance from this Court, the present case would not be decided differently in any of those circuits.

For example, petitioners note that in *U.S. ex rel. SNAPP, Inc.* v. *Ford Motor Co.*, 532 F.3d 496 (6th Cir. 2008), the Sixth Circuit remarked that a defendant's

state of mind need only be pled "generally," quoting the language in Rule 9(b). Pet. 19. But they fail to mention that the Sixth Circuit *affirmed* the Rule 9(b) dismissal in *SNAPP* and emphasized that a complaint must state enough facts to support a "plausible" claim. 532 F.3d at 502. That holding is entirely consistent with the Fifth Circuit's decision in this case.

Petitioners also cite *Anderson* v. *Sara Lee Corp.*, 508 F.3d 181 (4th Cir. 2007). Pet. 19. But petitioners fail to mention that on appeal, the defendant in *Anderson* "[t]ellingly" did not rely "on the proposition that the Class Action Complaint fails to allege the intent to deceive" and argued for affirmance based solely on reliance grounds. 508 F.3d at 189 n.8. No such issue is present in this case.

Petitioners next cite *Hefferman* v. *Bass*, 467 F.3d 596 (7th Cir. 2006). Pet. 19. But petitioners' characterization of *Hefferman* oversimplifies the state of the law in that circuit. The *Hefferman* court applied a pre-*Twombly* "notice pleading" standard (under which "the plaintiff is not required to plead either facts or legal theories") and distinguished the pre-*Twombly* federal Rule 8 regime from the requirement in Illinois state courts that "'the plaintiff must allege facts sufficient to bring a claim within a legally recognized cause of action, not simply conclusions.'" 467 F.3d at 599. As the Seventh Circuit now recognizes, *Twombly* has supplanted this lenient application of Rule 8. *See Hecker* v. *Deere & Co.*, 556 F.3d 575, 580 (7th Cir. 2009) (following *Twombly*, a complaint must allege "enough facts to state a claim to relief that is plausible on its face") (internal quotation marks and citations omitted).

Petitioners also cite *Morganroth & Morganroth* v. *Norris, McLaughlin & Marcus, P.C.*, 331 F.3d 406 (3d Cir. 2003), and *In re Navarre Corp.*, 299 F.3d 735, 742 (8th Cir. 2002). Pet. 19-20. Again, however, petitioners' descriptions of those cases omit key distinctions. In *Morganroth*, the Third Circuit listed the numerous detailed facts pled in the complaint and held that "[t]he fraud allegations are sufficiently particular because they allege specific actions by which defendants exceeded the bounds of advocacy." 331 F.3d at 414 n.2. The entirety of the court's Rule 9(b) analysis was contained in a single footnote and does not support the proposition that parties need not plead facts supporting a plausible inference of fraud. In *In re Navarre*, the Eighth Circuit merely quoted Rule 9(b); it did not hold that a plaintiff was excused from pleading facts supporting a plausible claim. 299 F.3d at 742.

Petitioners' final two citations on this issue likewise fail to demonstrate a circuit split. In *Wight* v. *BankAmerica Corp.*, 219 F.3d 79, 92 (2d Cir. 2000), the court specifically analyzed whether the factual allegations demonstrated "the requisite knowledge on the part of [the defendant]," using an approach virtually indistinguishable from the Fifth Circuit's. *Id.* And in *West Coast Roofing & Waterproofing, Inc.* v. *Johns Manville, Inc.*, 287 Fed. Appx. 81 (11th Cir. 2008), the court expressly held that Rule 9(b) "requires more than conclusory allegations that certain statements were fraudulent; it requires that a complaint plead facts giving rise to an inference of fraud." *Id.* at 86. This unpublished decision has no precedential value even in the Eleventh Circuit, and is in any event consistent with the Fifth Circuit's decision in this case.

In addition to their failure to establish a circuit split, petitioners have not cited any authority to substantiate their claim that the Fifth Circuit applies a "heightened" Rule 9(b) standard to certain types of fraud actions but not others. Pet. 20. Contrary to petitioners' assertion, the Fifth Circuit has faithfully and consistently applied the same "inference of fraud" standard in all cases under Rule 9(b), sometimes allowing dismissals, sometimes reversing. *See Dorsey* v. *Portfolio Equities, Inc.*, 540 F.3d 333, 341-43 (5th Cir. 2008) (analyzing whether complaint supported "inference of scienter" and reversing dismissal of fraud claim); *Am. Realty Trust, Inc.* v. *Hamilton Lane Advisors, Inc.*, 115 Fed. Appx. 662, 667-68 (5th Cir. 2004) (applying "inference of fraud" test and affirming dismissal of fraud claim); *U.S. ex rel. Willard* v. *United Health Plan of Tex. Inc.*, 336 F.3d 375, 385 (5th Cir. 2003) (applying "inference of fraud" test to False Claims Act case and affirming dismissal). Petitioners cite no authority for their claim that the Fifth Circuit applies a different standard in "business fraud" cases than in "ordinary" fraud cases.

The cases from other circuits cited by petitioners similarly apply no double standard. In *U.S. ex rel. Wilson* v. *Kellogg Brown & Root, Inc.*, 525 F.3d 370 (4th Cir. 2008), the court simply adopted the same articulation of Rule 9(b) endorsed in *Iqbal*. *See id.* at 379 ("Although '[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally,' * * * an FCA plaintiff still 'must set forth specific facts that support an inference of fraud'") (quoting *Willard*, 336 F.3d at 385). Likewise, *North Am. Catholic Educ. Programming Found. Inc.* v. *Cardinale*, 567 F.3d 8, 13 (1st Cir. 2009), applies the

Twombly-Iqbal rule that requires plaintiffs to set forth specific facts that make it "reasonable to believe that defendant(s) knew that a statement was materially false or misleading." None of these decisions holds that Rule 9(b) applies differently in particular types of fraud cases.

Thus, there is no disagreement in the circuits. The cases cited in the petition are consistent with each other, as well as with the legions of other circuit court decisions applying the same rule as set forth in *Twombly* and *Iqbal—i.e.*, that a complaint must set forth sufficient factual allegations to support a plausible inference of the required state of mind.[1]

B. There Is No Circuit Split Or Unsettled Question Of Law Regarding The Pleading Standards For Section 14(e) Claims.

Petitioners also suggest the Court should grant certiorari to clarify the standards for pleading a

---

[1] *See, e.g., Eternity Global Master Fund Ltd.* v. *Morgan Guar. Trust Co. of N.Y.*, 375 F.3d 168, 187 (2d Cir. 2004) ("Although '[m]alice, intent, knowledge and other condition of mind of a person may be averred generally,' * * * this leeway is not a 'license to base claims of fraud on speculation and conclusory allegations'") (citation omitted); *In re Burlington Coat Factory Secs. Litig.*, 114 F.3d 1410, 1418 (3d Cir. 1997) ("While state of mind may be averred generally, plaintiffs must still allege facts that show the court their basis for inferring that the defendants acted with 'scienter'"); *DiLeo* v. *Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990) ("Although [Rule] 9(b) does not require 'particularity' with respect to the defendants' mental state, the complaint still must afford a basis for believing that plaintiffs could prove scienter."); *K-Tel Int'l Inc. Sec Litig.* v. *K-Tel Int'l Inc.*, 300 F.3d 881, 894 (8th Cir. 2002) (holding that "'conclusory allegations' do not satisfy the pleading requirements of [FRCP] 9(b)," and that "unsupported allegations with regard to motives generally possessed by all corporate directors and officers are insufficient" to plead fraudulent intent under Rule 9(b)).

Section 14(e) claim. Pet. i. But these standards require no such clarification. Courts have uniformly held that Section 14(e) claimants must plead and prove scienter to the same extent as Section 10(b) claimants. *See, e.g., S.E.C.* v. *Ginsburg*, 362 F.3d 1292, 1297-98 (11th Cir. 2004) ("to establish liability under § 10(b) and §14(e) * * *, the SEC must prove that [the defendant] acted with scienter"); *In re Digital Island Secs. Litig.*, 357 F.3d 322, 328-29 (3d Cir. 2004) ("Section 14(e) is 'modeled on the antifraud provisions of § 10(b) * * * and Rule 10b-5,' which require proof of scienter.") (citations omitted); *Conn. Nat'l Bank* v. *Fluor Corp.*, 808 F.2d 957, 961 (2d Cir. 1987) ("Insofar as [§ 10(b)] cases deal with the adequacy of allegations of scienter, they are applicable to claims under the Williams Act."). Petitioners cite no authority for their apparent belief that "tender offer" cases under Section 14(e) are subject to a lower scienter requirement than "regular" Section 10(b) cases. Nor do petitioners cite any disagreement among the circuits over the scienter requirement for Section 14(e) claims.

Given that Section 14(e) has the same scienter requirement as Section 10(b), this Court's analysis of the scienter requirement in *Tellabs* controls petitioners' Section 14(e) claim to the same extent as their Section 10(b) claim. In *Tellabs*, this Court held that a Section 10(b) complaint must allege particularized facts supporting an inference of fraudulent intent that is "cogent and at least as compelling as any opposing inference of nonfraudulent intent." *Tellabs*, 551 U.S. at 314. The district court must perform a "comparative assessment" of competing inferences to determine whether facts giving rise to a strong inference have been pled. *Id.* at 2511-12. Petitioners

do not even suggest that the district court or Fifth Circuit misapplied this well-settled test. And given that this Court squarely addressed the scienter requirement in *Tellabs*, there is no reason to grant certiorari here to address the scienter issue yet again.

Petitioners attempt to manufacture controversy by citing cases from other circuits involving "cautionary language." Their citations are misleading; the decisions petitioners reference address the effect of cautionary language on the distinct elements of materiality and falsity, rather than the scienter requirement at issue in this appeal. *See* Pet. 21 (citing *Halperin* v. *eBanker USA.com, Inc.*, 295 F.3d 352, 359 (2d Cir. 2002) (holding that cautionary language rendered statement non-misleading under "bespeaks caution" doctrine as a matter of law); *Fecht* v. *Price Co.*, 70 F.3d 1078, 1081-83 (9th Cir. 1995) (addressing effect of cautionary language on materiality and falsity requirements); *Shaw* v. *Digital Equip. Corp.*, 82 F.3d 1194, 1213-14 (1st. Cir. 1996) (same)). Because the Fifth Circuit was focused here on scienter, petitioners' cited cases are inapposite. Moreover, unlike petitioners' cases, neither the district court nor the Fifth Circuit relied on the existence of cautionary language as a stand-alone basis for dismissal or held that the language precluded petitioners' claims as a matter of law.[2] Instead, the courts considered the cautionary disclosures as but one factor in a holistic analysis of the entire complaint to determine whether the required inference of scienter was established.

---

[2] *Cf. Lormand*, 565 F.3d at 243-48 (discussing PSLRA cautionary "safe harbor" statement as stand-alone basis for dismissal); *Halperin*, 295 F.3d at 359 (discussing "bespeaks caution" doctrine as stand-alone basis for dismissal).

This case thus presents a poor vehicle for addressing the sufficiency of cautionary language on a motion to dismiss. TXU's disclosures were not merely "boilerplate" but rather were specifically tailored to the company's circumstances at the time they were made, and they were just one factor in the lower courts' comprehensive scienter analysis. Given the lack of any disagreement in the circuits, there is no basis for this Court to address that issue. But if the Court were ever to do so, it should do so in a case that squarely presents the question whether cautionary language can be a sufficient independent ground for dismissal.

II. THE FIFTH CIRCUIT'S DECISION INVOLVES THE CORRECT APPLICATION OF SETTLED LAW.

Far from identifying any circuit split or controversial legal issue of national importance warranting certiorari, the petition is simply a run-of-the-mill challenge to the appellate court's application of settled law to what petitioners admit are the "unique" facts of this case. Petitioners complain that the district court and unanimous Fifth Circuit panel failed to draw the proper inferences from petitioners' factual allegations and should have found a plausible inference of scienter. Even assuming such an exercise in "error correction" could form an appropriate basis for certiorari, there is simply no error to correct in this case.

A. The Fifth Circuit Applied The Same Standard As *Twombly* And *Iqbal*.

In affirming dismissal of the common law claim, the Fifth Circuit applied a standard identical to the one articulated in *Twombly* and *Iqbal*. It required

that the complaint "'set forth specific facts to support an inference of fraud.'" Pet. App. 22a (citation omitted). This squares precisely with *Iqbal*'s holding that the "alleged generally" language in Rule 9(b) does not excuse a plaintiff from pleading sufficient facts to "show" the required state of mind for purposes of Rule 8; the complaint must still plead facts supporting a "plausible" inference of the required intent. The Fifth Circuit correctly recognized that while the PSLRA's "strong inference of scienter" standard does not apply in common law fraud cases, the facts must still support an "inference" sufficient under Rule 8 that the defendants acted with the requisite fraudulent intent. Pet. App. 22a. There is, accordingly, no difference between the standard applied in *Twombly* and *Iqbal* and the standard employed by the Fifth Circuit in affirming dismissal.

B. Petitioners' Allegations Fail To Support A Plausible Inference Of Fraud As Required By Rule 8.

The weakness of petitioners' factual allegations underscores the correctness of the lower courts' decisions to grant and affirm dismissal. This matter presents the classic situation envisioned by *Twombly* and *Iqbal*. The allegations are, at best, merely "consistent with" the defendants' liability and are not sufficient for the court "to draw the reasonable inference that the defendant[s are] liable for the misconduct alleged." *Iqbal*, 129 S. Ct. at 1949.

Every one of petitioners' assertions—that TXU hired outside advisers, communicated with credit rating agencies about the dividend policy, scheduled Board meetings to discuss the dividend policy, and ultimately decided to increase the dividend after the

tender offer—is fully consistent with TXU's disclosure that it was "review[ing]" and "evaluat[ing]" the dividend during the tender offer. Petitioners do not allege that TXU took a single action inconsistent with its disclosures. Without more, the allegations fail to nudge "across the line from conceivable to plausible," *Twombly*, 550 U.S. at 570, the inference that TXU *must have known* during the tender offer what the final outcome of the dividend and stock repurchase would be and deliberately or recklessly misrepresented or concealed this information during the tender offer. *Id.* at 1955.

Petitioners' proposed inference of fraud is particularly implausible given the absence of any allegation that TXU management received feedback from the credit rating agencies before the tender offer closed, as well as the admissions in petitioners' own "expert report." Those admissions establish that: (i) credit ratings are "predicated on a host of qualitative or judgmental factors" and are "as much an art as it is a science"; (ii) rating agencies "would have been particularly careful in evaluating companies with only marginally investment grade credit ratings" such as TXU, which had a near-junk rating at the time; (iii) during October 2004, "Moody's was conducting overwhelmingly negative rating actions, reviews, and outlooks in the utilities industry" following the downfall of Enron; (iv) nearly 30% of companies that increased their dividends by more than 100% from 2000-06 suffered a ratings downgrade; (v) TXU's energy trading business depended on having an investment-grade rating; and (vi) "[a] single notch decline" in TXU's rating would have had "disastrous effects on the Company * * *." Pet. App. 117a-125a, 142a-143a, 164a. In light of

these concessions, it is not surprising the district court and Fifth Circuit found petitioners' fraud allegations to be insufficient.

The allegations in this case are just as insufficient as the allegations in *Twombly* and *Iqbal*. In *Twombly*, the plaintiff asked the Court to infer an agreement to restrain trade from various allegations of parallel conduct by different parties to resist competition. *Twombly*, 550 U.S. at 564. In *Iqbal*, the plaintiff asked the Court to infer discriminatory intent from the allegation that Arab Muslims were detained in disproportionate numbers after the attacks of September 11, 2001, and held under highly restrictive conditions until cleared by the FBI. In both cases, the Court held the allegations were, at best, merely "consistent with" the possibility of tortious conduct and did not cross the line into "plausibility." This case likewise fails to cross that threshold given that TXU expressly disclosed it was reviewing the dividend at the same time as the tender offer and acted consistently with its disclosures.

Petitioners ignore this Court's repeated commands that allegations be evaluated "collectively" and attempt to fabricate various bright-line legal issues based on individual allegations divorced from their broader context. For example, petitioners claim the September disclosures regarding TXU's review of the dividend and stock repurchase policies were "boilerplate" and therefore should be freely disregarded. But this allegation ignores the specific context in which the disclosures were made. Just four months earlier, in May 2004, TXU disclosed that it anticipated being in a position to recommend a re-evaluation and increase in TXU's dividend policy by

2006. Pet. App. 63a-64a. The September 2004 disclosures, however, advised investors that TXU had *already begun evaluating* its dividend policy at the time of the tender offer.[3] As the district court noted, nearly 35% of potential class members declined to participate in the tender offer after receiving these statements. Pet. App. 40a. Given the specific context of TXU's disclosures, the Fifth Circuit correctly determined that petitioners failed to allege facts supporting a plausible inference of scienter.

Petitioners similarly insist that the proximity in time between the close of the tender offer and the announcement of the dividend increase and stock repurchase should be sufficient by itself to support the required inference of fraud, without regard to the context of petitioners' allegations. Pet. 9-10. Again, however, whether timing is probative of fraud in a particular action is a case-by-case determination depending on the specific quantum of facts alleged. The Fifth Circuit has found timing to be probative of scienter where the overall context warrants such an inference.[4]

---

[3] Petitioners' assertion that they missed the significance of the September 2004 disclosures, Pet. 4, is particularly unconvincing given petitioners' claim that they are "sophisticated" investment entities who are particularly attuned to TXU's disclosures. *Id.* at 14.

[4] *See Plotkin* v. *IP Axess Inc.*, 407 F.3d 690, 698 (5th Cir. 2006) ("Nevertheless, allegations of later-emerging facts can, in some circumstances, provide warrant for inferences about an earlier situation. For example, the fact that a business files for bankruptcy on 'Day Two,' may, under the right surrounding circumstances, provide grounds for inferring that the business was performing poorly on 'Day One.'"). And other courts have found timing insufficient by itself to support an inference of fraud when the totality of factual allegations do not justify an

In this case, however, the Fifth Circuit properly held that when petitioners' allegations are taken in context and evaluated collectively, the mere proximity between the close of the tender offer and the announcement of the dividend increase and stock repurchase fail to support a plausible inference of fraud. As noted above, petitioners' own expert conceded that credit ratings are complex and subjective and would likely be affected by a dividend change at a company like TXU, and that a change in TXU's rating would have been disastrous for the company. As a result, petitioner's own factual allegations establish that the views of the credit agencies, which were not received until after the tender offer closed, were critical to any dividend decision. The Fifth Circuit thus correctly held that no plausible inference of fraud can be discerned from the simple fact that the decision to increase the dividend was not made until after the rating agencies' input was received, particularly given that TXU also expressly disclosed that the dividend and stock repurchase review was occurring at the same time as the tender offer.

Petitioners' "motive" allegations are similarly deficient. *See* Pet. 31. In *Tellabs*, this Court

---

inference of fraud. *See Yourish* v. *Cal Amplifier*, 191 F.3d 983, 997 (9th Cir. 1999) ("[T]he temporal proximity of the August disclosure to the June and July statements, without more, is insufficient to satisfy Rule 9(b)"); *Gross* v. *Summa Four, Inc.*, 93 F.3d 987, 995 (1st Cir. 1996) (no inference of scienter when proximity was five weeks); *In re Digital Island Sec. Litig.*, 223 F. Supp. 2d 546, 555-56 (D. Del. 2002), *aff'd*, 357 F.3d 322 (3d Cir. 2004) (fact that company disclosed two successful deals within three weeks after tender offer completed, including one deal two days after offer, does not establish that company had knowledge of these transactions at time tender offer was made).

recognized that the presence or absence of "motive" allegations is not dispositive of whether the required inference of fraud has been pled, which depends on the totality of the complaint. *Tellabs*, 551 U.S. at 325. The only "motives" alleged by petitioners are that: (i) TXU wanted to complete the tender offer and (ii) Wilder wanted to increase the value of his personal stock holdings. To infer fraudulent intent from universal motives such as these would effectively eliminate the scienter requirement in fraud cases. The Fifth Circuit's refusal to indulge such inferences is consistent with the approach taken in other circuits and is fully in line with *Iqbal*'s command that allegations be considered in context.[5]

Finally, the petition does not challenge the Fifth Circuit's articulation of the disclosure standard for tender offerors, which further undermines any conceivable inference of fraud from TXU's disclosures. Under Fifth Circuit precedent, a tender offeror "is not required to make predictions of future behavior, however tentatively phrased, which may

---

[5] *See, e.g., Institutional Investors Group* v. *Avaya, Inc.*, 564 F.3d 242, 278 (3d Cir. 2009) ("'[M]otives that are generally possessed by most corporate directors and officers do not suffice,'" and a "general corporate desire to retire debt and raise funds and obtain credit on favorable terms" is insufficient to support a strong inference of fraud) (quoting *Kalint* v. *Eichler*, 264 F.3d 131, 139 (2d Cir. 2001)); *Cozzarelli* v. *Inspire Pharm Inc.*, 549 F.3d 618, 627 (4th Cir. 2008) ("[T]he motivations to raise capital or increase one's own compensation are common to every company and thus add little to an inference of fraud"); *GSC Partners CDO Fund* v. *Washington*, 368 F.3d 228, 237 (3d Cir. 2004) ("In every corporate transaction, the corporation and its officers have a desire to complete the transaction, and officers will usually reap financial benefits from a successful transaction. Such allegations alone cannot give rise to a 'strong inference' of fraudulent intent.").

cause the offeree or the public investor to rely on them unjustifiably." *Susquehanna Corp.* v. *Pan Am. Sulphur Co.*, 423 F.2d 1075, 1085-86 (5th Cir. 1970). This approach is consistent with that taken by other courts.[6] In light of this standard, it can hardly be said that TXU's disclosure that the dividend was "under review," without providing further speculation regarding the likelihood, magnitude, or timing of any possible dividend change, was such an extreme departure from the standard of ordinary care as to be reckless or fraudulent.

Accordingly, taking the allegations collectively as *Twombly* and *Iqbal* require, the Fifth Circuit correctly concluded that the inference of fraud from petitioners' factual allegations did not cross the threshold from "permissible" to "plausible."

C. The Fifth Circuit Did Not Engage In Impermissible Fact-Finding.

Petitioners also incorrectly assert that the lower courts resolved disputed issues of fact and failed to

---

[6] *See Warner Commc'ns, Inc.* v. *Murdoch*, 581 F. Supp. 1482, 1491 (D. Del. 1984); *Todd Shipyards Corp.* v. *Madison Fund, Inc.*, 547 F. Supp. 1383, 1387 (S.D.N.Y. 1982); *see also Reiss* v. *Pan Am. World Airways*, 711 F.2d 11, 14 (2d Cir. 1983); *Chromalloy Am. Corp.* v. *Sun Chem. Corp.*, 611 F.2d 240, 248 (8th Cir. 1979); *Shamrock Holdings, Inc.* v. *Polaroid Corp.*, 709 F. Supp. 1311, 1327 (D. Del. 1989). The principle that contingent disclosures are not required has been reiterated numerous times in the merger context, where it is well-settled that tender offerors are not required to disclose preliminary merger discussions and even tentative merger agreements. *See Taylor* v. *First Union Corp. of S.C.*, 857 F.2d 240, 244-45 (4th Cir. 1988); *Mo. Portland Cement Co.* v. *H.K. Porter Co.*, 535 F.2d 388, 398 (8th Cir. 1976); *Feder* v. *MacFadden Holdings, Inc.*, 698 F. Supp. 47, 51 (S.D.N.Y. 1988); *Berman* v. *Gerber Prods. Co.*, 454 F. Supp. 1310, 1316, 1318 (W.D. Mich. 1978).

take petitioners' allegations as true. Pet. 24-26. For example, petitioners argue that the Fifth Circuit accepted TXU's account of the need for credit rating input before making a recommendation regarding the dividend policy. Petitioners inaccurately assert throughout the petition that the lower courts "decide[d] contested facts," "resolve[d] disputes of fact," "chose ultimately to credit TXU's account of the facts," "resolve[d] contested factual issues," "resolve[d] contested facts," "credit[ed TXU's] rendition of facts," offered a "summary resolution of disputed facts," and engaged in "what can only be described as fact finding." *Id.* at 6, 14, 26, 28, 29.

Petitioners misunderstand the difference between the resolution of disputed facts, which courts are prohibited from doing on a Rule 12(b)(6) motion, and the weighing of inferences from facts that are pled, which courts are *required* to do in determining whether the requisite inference of fraud has been established. The district court and Fifth Circuit did not "credit" one version of facts over another; they simply accepted petitioners' allegations as true and found the inferences from those allegations insufficient. *See* Pet. App. 12a, 36a, 42a-46a.

Importantly, it is petitioners' burden under *Tellabs*, *Twombly*, and *Iqbal* to plead sufficient facts to support the required inference of fraud. Courts are not required to assume facts that have not been pled or accept proffered inferences and legal conclusions as true. In this vein, petitioners offered no specific factual allegation that, before the tender offer closed, TXU management (and Wilder specifically) knew what the dividend recommendation would be or received any assurance from the credit rating agencies that a dividend increase would not affect

the company's credit rating. Particularly given the numerous admissions by petitioners' own expert, the lower courts were not required to take the unwarranted leap of logic urged by petitioners and simply assume that TXU had this information in advance absent a specifically pled fact showing such knowledge. Taken in context and examined holistically, the allegations failed to allege sufficient facts demonstrating that TXU intentionally or recklessly deceived investors regarding its dividend and stock repurchase policies.

III. THIS CASE PROVIDES AN UNSUITABLE VEHICLE FOR REVIEWING THE QUESTIONS PRESENTED.

Petitioners assert that this case presents "an excellent vehicle" for considering the questions presented. Pet. 28. For several reasons, nothing could be further from the truth.

First, any decision on the questions presented in this case will necessarily be confined to its facts and will have little precedential value. As petitioners themselves repeatedly admit, the facts of this case are "unique." Pet. 6, 7, 8. Whether a particular set of facts supports the required inference of fraudulent intent is, of course, "a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." *Iqbal*, 129 S. Ct. at 1950. The district court must consider the allegations "collectively," and the significance attached to one particular type of allegation "depends on the entirety of the complaint." *Tellabs*, 551 U.S. at 325. A determination whether the specific fact pattern of this case supports the required inference of scienter will necessarily be limited to its facts and will offer little guidance to courts dealing with the near-

infinite array of other conceivable fact patterns that may arise in future cases.

Second, the timing of this case makes it particularly ill-suited for review. As shown above, the lower courts are continuing without difficulty to apply this Court's recent decisions to the myriad factual contexts that come before them. Given that the Court has elucidated different aspects of pleading standards three times in the last three Terms, there is no basis for the Court to revisit those issues yet again. Moreover, given this Court's recent pronouncements, if any change in the law of pleading is needed, it should come from Congress. Indeed, Congress is presently considering a bill that, if enacted, would alter the standards for pleading claims and moot any conceivable action by this Court in this case. *See* Notice Pleading Restoration Act of 2009, S. 1504, 111th Cong. (2009). That is the appropriate forum for debating these issues.

Finally, the scienter issue that petitioners raise is not outcome-determinative. This case would be decided the same way regardless of whether petitioners adequately pled scienter, because their factual allegations fail to establish the existence of another critical element of their cause of action—a false or misleading statement. The Fifth Circuit noted that "it is not clear that Appellees ever issued a materially misleading statement or omission of fact concerning the dividend policy." Pet. App. 16a. The district court likewise concluded that "simply because the plaintiffs were misled, the court does not therefore find TXU's statements to be misleading; the plaintiffs fail to show *how* each statement was fraudulent." *Id.* 47a. Needless to say, a party cannot act with the requisite intent to defraud if it never

made a false or misleading statement in the first place. Respondents thus would be entitled to raise that issue as an alternative ground for affirmance here—or as an alternative ground for dismissal on remand—and it is thus entirely possible, if not likely, that the judgment would remain intact without respect to petitioners' scienter-based argument.

* * *

In sum, this case provides no basis for certiorari. The pleading issues have been addressed by *Twombly* and *Iqbal*. Petitioners identify no avalanche of fraud cases involving self-tender offers suggesting a pressing issue for certiorari, let alone any controversy regarding how Section 14(e) claims should be pled. And the weakness of petitioners' factual allegations, the correctness of the Fifth Circuit's approach, as well as the inherently fact-specific nature of the questions presented render this case an unsuitable candidate for further review.

CONCLUSION

For these reasons, the petition should be denied.

Respectfully submitted,

GERARD G. PECHT*
RICHARD S. KRUMHOLZ
FULBRIGHT & JAWORSKI L.L.P.
2200 Ross Avenue, Suite 2800
Dallas, Texas 75201-2784
(214) 855-8050

PETER A. STOKES
FULBRIGHT & JAWORSKI L.L.P.
600 Congress, Suite 2400
Austin, Texas 78701
(512) 536-5287

* *Counsel of Record* *Counsel for Respondents*

(3)

No. 09-2

Supreme Court, U.S.
FILED
SEP 9 - 2009
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED, *et al.*,
Petitioners,

v.

TXU CORP., *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

REPLY TO BRIEF IN OPPOSITION

FRANCIS J. BALINT JR.
BONNETT FAIRBOURN
FRIEDMAN & BALINT PC
2901 N. Central Avenue,
Suite 1000
Phoenix, AZ 85012

DAVID W. DODGE
DAVID W. DODGE PC
Regency Plaza
3710 Rawlins, Suite 1600
Dallas, TX 75219

SAMUEL ISSACHAROFF
Counsel of Record
40 Washington Square South
New York, NY 10012
(212) 998-6580

ROSEMARY SHOCKMAN
SHOCKMAN LAW OFFICE PC
3001 E. Camelback,
Suite 120
Phoenix, AZ 85016

Counsel for Petitioners

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
ARGUMENT	1
I. THE COURT NEEDS TO CLARIFY HOW COURTS ON A MOTION TO DISMISS SHOULD WEIGH THE PLAUSIBILITY OF FACTUAL INFERENCES WITHOUT RESOLVING DISPUTED ISSUES OF FACT.	1
II. CONTRARY TO THE OTHER CIRCUITS AND TO THE COURT'S PRECEDENT, THE FIFTH CIRCUIT IS APPLYING A HEIGHTENED PLEADING STANDARD TO COMMON LAW FRAUD CLAIMS AGAINST "CORPORATIONS AND THEIR OFFICERS."	8
CONCLUSION	11

TABLE OF AUTHORITIES

CASES Page(s)

ABC Arbitrage Plaintiffs Group v. Tchuruk, 291 F.3d 336 (5th Cir. 2002) 9
Ashcroft v. Iqbal, 129 S.Ct. 1937 (2009) .....*passim*
Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007).....*passim*
Dorsey v. Portfolio Equities, Inc., 540 F.3d 333 (5th Cir. 2008)..... 9
Limestone Development Corp v. Village of Lemont, 520 F.3d 797 (7th Cir. 2008)..... 5
Marrero-Gutierrez v. Molina, 491 F.3d 1 (1st Cir. 2007) 6
Shady Grove Orthopedics Assocs., P.A. v. Allstate Ins. Co., 549 F.3d 137 (2d Cir. 2008), *cert. granted*, 129 S.Ct. 2160 (2009)..... 10
Showalter v. Brubaker, 283 F. App'x 35 (3d Cir. 2008) 6
Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007).....*passim*
Tel-Phonic Servs., Inc. v. TBS Int'l, Inc., 975 F.2d 134 (5th Cir. 1992)..... 9
Tuchman v. DSC Commc'ns Corp., 14 F.3d 1061 (5th Cir. 1994)..... 9
Williams v. WMX Techs., Inc., 112 F.3d 175 (5th Cir. 1997)..... 9

STATUTES & RULES

Fed. R. Civ. P. 9(b).....*passim*
Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b) (1), (2) .....*passim*

MISCELLANEOUS

Geoffrey P. Miller, *Pleading After Tellabs*, 2009 Wisc. L. Rev. 507..... 4

IN THE

Supreme Court of the United States

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED, *et al.*,

Petitioners,

v.

TXU CORP., *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

REPLY TO BRIEF IN OPPOSITION

ARGUMENT

I. THE COURT NEEDS TO CLARIFY HOW COURTS ON A MOTION TO DISMISS SHOULD WEIGH THE PLAUSIBILITY OF FACTUAL INFERENCES WITHOUT RESOLVING DISPUTED ISSUES OF FACT.

The Court's recent pleading cases have expanded the boundaries of a district court's inquiry on a motion to dismiss based on the "plausibility" of factual allegations in a complaint. Thus, courts may dismiss a complaint when the facts of record support an inference favoring lawful as opposed to unlawful conduct (*Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 556-57 (2007)), or when it simply tracks the

elements of the underlying cause of action (*Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1951 (2009)), and may additionally dismiss a complaint for securities fraud under the PSLRA[1] if the facts of record do not, of their own, present a plausible inference of scienter (*Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322-24 (2007)). However, the Court has not yet established the outer boundaries of the inquiry into "plausibility." No case has yet instructed lower courts how to avoid crossing the line into impermissible fact-finding at the motion to dismiss stage.

As a result of this void, there is a serious risk that in cases like that at bar, a detailed complaint may be dismissed based on a district court's accepting as fact the version of events offered by defense counsel via motion to dismiss. This case offers the Court a clear opportunity to provide guidance to the lower courts on the full import of the refined pleading requirements, signaling not only what may be dismissed as implausible, but what factual allegations must be respected given the early stage of litigation at which a motion to dismiss is made.

The facts in the present case present the critical pleading issues in clear relief. At issue are the public representations made by TXU concerning the likelihood of a dividend payout increase following the close of its tender offer. There is no dispute in this case that the securities at issue were a specialized instrument whose value largely tracked the anticipated dividends from TXU. Both before and during the tender offer period, TXU announced certain financial benchmarks (in turn filed with the SEC)

---

[1] Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b) (1), (2)

that conditioned any prospective increase in dividends on the successful completion of the stated financial targets. Those benchmarks in turn projected no increase in dividends until 2006.

Despite the announced benchmark criteria for raising dividends, and despite the fact that the criteria had not been met, TXU increased its dividends by an unprecedented 350% *only eight days after the tender offer expired*. Further, the meeting of the Board of Directors at which the increase was approved had been scheduled well in advance of the tender offer, and all the materials submitted for Board approval were prepared by management *during* the tender offer.

Most critically, during the self-tender period, TXU and its CEO Wilder on September 28, 2004 gave a presentation to analysts in which Wilder reiterated the benchmark criteria applicable to any TXU dividend increase, a reiteration that obscured and misrepresented the preparations that were in fact underway for a massive dividend increase as soon as the tender offer expired.[2]

These facts are all alleged in the Second Amended Complaint ("SAC"), and alleged with great specificity as to when made, why they were so material to the investment decisions of sophisticated investors who

---

[2] Inexplicably, Respondents argue that "Petitioners do not allege that TXU took a single action inconsistent with its disclosures." Resp't Br. at 31. The Second Amended Complaint details how the sudden and unprecedented dividend increase was inconsistent with the financial guidelines that TXU had provided to the investing market. *See, e.g.*, Pet. App. 62a-70a (detailing repeated public statements of guidelines for dividend increase, which were disregarded in raising dividends immediately after close of tender offer).

traded in the specialized securities at issue,[3] and why the representations were false when made. Neither the district court nor the Fifth Circuit found that this set of facts as set out in the SAC failed to state a plausible claim of the requisite scienter. Rather, the SAC was dismissed because the district court chose to credit an alternative set of facts advanced by TXU's legal counsel and having no documentary support in any filing before the SEC or other public record. The district court unilaterally concluded that this set of facts was more likely the truth as to scienter, a conclusion that was affirmed by the Fifth Circuit.[4] Such an assessment surely goes far beyond anything envisioned in the Court's recent pleading cases and allows a defendant to move to dismiss on a

---

[3] Professor Geoffrey Miller well states the significance of the materiality of the representations to the question of scienter:

> [S]ophisticated businesspeople understand that when information is material—when it is important to market actors in deciding whether to buy, sell, or hold the company's shares—they need to be especially careful to verify the truth of what they are saying . . . . Because people will usually be especially careful when the information is material, as compared to when it is not, the fact that a material statement turns out to be false enhances the suspicion that the person making the statement knew it was false (or was reckless with respect to its truth).

Geoffrey P. Miller, *Pleading After* Tellabs, 2009 Wisc. L. Rev. 507, 517.

[4] Respondent's claim that the scienter issue is not dispositive of the case, Resp't Br. at 29-30, is false. The district court squarely held that "[t]he only real issue in granting the motion to dismiss was whether TXU 'acted with the requisite scienter.'" Pet. App. 39a. In turn, the Fifth Circuit affirmed on the basis that the evidence presented did not establish the intent of TXU and its CEO Wilder to deceive. Pet. App. 21a.

hypothesized set of facts never tested or in any fashion verified.

This case highlights the need to refine the plausibility inquiry because the courts below had to acknowledge not only that Petitioners had set out a plausible claim of liability, but that the facts of record provided specific support to their allegations. Thus, the Fifth Circuit acknowledged that the timing of the dividend increase was "suspect," Pet. App. 15a, that it "provides some support for an inference of scienter," Pet. App. 16a, that the Petitioners' expert report likewise "provides some support for the notion that TXU's management likely made preparations for the dividend increase before the end of the tender offer,"[5] Pet. App. 17a, that the generic disclaimer of "under review" was itself "vague," Pet. App. 18a, and ultimately conceded that the inference of scienter on these facts was "permissible." Pet. App. 20a.

What sets this case apart from *Twombly* and *Iqbal* is that both lower courts here unabashedly substituted their own assessment of the facts for those that had been pleaded. The Fifth Circuit did not—and could not—find that this was a case that could be dismissed at the pleading stage because the allegations were "[t]hreadbare" and "far-fetched." *Limestone Development Corp v. Village of Lemont*, 520 F.3d 797, 804 (7th Cir. 2008) (Posner, J.). Nor did the Fifth Circuit find that the allegations support an

---

[5] Petitioners submitted a long analysis of the rating system used by credit agencies to assess utility companies such as TXU. Pet. App. 108a-151a. The author, Dr. Linda Allen, is a Ph.D. economist in finance, specializing in risk management measures. Pet. App. 152a. Respondents erroneously and dismissively refer to her as a law professor. Resp't Br. at 8. Dr. Allen is a professor at one of the nation's leading business schools.

inference contrary to the illegal conduct alleged. *See, e.g., Showalter v. Brubaker*, 283 F. App'x 35 (3d Cir. 2008) (finding "no allegations from which it could reasonably infer" that the defendants acted under color of state law). Nor did the Fifth Circuit find that the allegations were equally consistent with either legal or illegal conduct. *See, e.g., Marrero-Gutierrez v. Molina*, 491 F.3d 1, 9 (1st Cir. 2007) (finding that the facts alleged supported non-actionable motivation for dismissal of state employee). In such cases, the lower courts are operating within the confines of the factual allegations of the complaint to determine whether a presumption of impropriety was created. Such holdings are consistent with the Court's repeated adherence to the "tenet that a court must accept as true all of the allegations in a complaint." *Iqbal*, 129 S.Ct. at 1949.

Here, by contrast, the Fifth Circuit took it upon itself to find that TXU's boilerplate disclaimer that the dividend structure was "under review" had the effect of conveying "that TXU had taken some steps in evaluating a change in the dividend policy," Pet. App. 17a, though that is directly contrary to the allegations in the SAC, to the analysis of market responses by Petitioners' expert, and to the contemporary statements of Flaherty & Crumrine, the lead plaintiff investment firm. Pet. App. 173a. The Fifth Circuit then found that proper disclosure of the imminence of the dividend increase was foreclosed by TXU's fear of liability, Pet. App. 18a, a conclusion tethered to nothing in the record and in fact contradicted by the allegations in the SAC. Most critically, the Fifth Circuit adds that "it can be inferred that Appellees had not made a final decision concerning a change in the dividend policy during the tender offer, and were thus truthfully stating that the policy was

under review." Pet. App. 20a. Again, this runs contrary to the allegations in the SAC and to the evidence in the expert report that describes in great detail the steps that had to be taken prior to a dividend increase of this magnitude.

Outright dismissal of a pleading like the SAC is surely not dictated by *Twombly* and *Iqbal*. The complaint in *Twombly* failed because, despite factual allegations of parallel conduct that were "well-pleaded," the allegations failed to "plausibly suggest an illicit accord" because the underlying parallel economic conduct "was not only compatible with, but indeed was more likely explained by, lawful, unchoreographed free-market behavior." *Iqbal*, 129 S.Ct. at 1950. Similarly, in *Iqbal* itself, the Court refused to allow a broad conspiracy claim to survive against the Attorney General and the Director of the FBI based merely on an allegation that Muslims were being detained after September 11th. The critical question was whether the facts as alleged created a plausible claim under the governing substantive law. Even accepting the facts as pleaded, the Court rejected the claim that "a supervisor's mere knowledge of his subordinate's discriminatory purpose amounts to the supervisor's violating the Constitution." *Id.* at 1949. Instead, liability under the controlling substantive law of *Bivens* must be based on the affirmative conduct of the named defendants, and the complaint did not plead any such conduct.

Ultimately, the issue of the truth or falsehood of the statements made to the investing market is the question for trial. The Court has instructed lower courts to use common sense and inferences to weigh the plausibility of the claims as stated. Because all of

this occurs at the motion to dismiss stage, before defendants have even answered or otherwise committed themselves to affirm or deny the truth of any allegation, and before they are subject to having factual representations tested in an adversarial proceeding, the Court emphasized that the factual universe must be the allegations of the complaint and whatever publicly available material helps make sense of them. Nowhere has the Court invited lower courts to speculate as to the likely correctness of contested facts, much less adopt as dispositive a set of facts outside the pleadings.

While lower courts are struggling to apply the plausibility standard of *Tellabs*, *Twombly*, and *Iqbal*, this case presents a chance to define the boundaries of impermissible fact-finding, as opposed to testing of the plausibility of the claim as asserted. Drawing this line is critical under the recent pleading cases and the Court should grant review to assist lower courts in this process.

II. CONTRARY TO THE OTHER CIRCUITS AND TO THE COURT'S PRECEDENT, THE FIFTH CIRCUIT IS APPLYING A HEIGHTENED PLEADING STANDARD TO COMMON LAW FRAUD CLAIMS AGAINST "CORPORATIONS AND THEIR OFFICERS."

To uphold dismissal of Petitioners' common law claims, the Fifth Circuit squarely held that "certain motives alleged, especially those universal to corporations and their officers, do not suffice to establish an inference of fraud under Rule 9(b)." Pet. App. 22a-23a. Respondents now argue that this application of a higher pleading threshold for motive against corporations and their officers should be disregarded

because the Fifth Circuit actually applies the same pleading standard to all claims, regardless of the nature of the alleged perpetrator of the fraud. Resp't Br. at 15 (Fifth Circuit "has faithfully and consistently applied the same 'inference of fraud' standard in all cases under Rule 9(b) . . ."). But one cannot simply ignore the Fifth Circuit's discussion of the specific claims of misconduct that do not suffice to satisfy the distinct pleading requirement for corporate fraud.

Nor is the application of a special pleading requirement for common law claims consistent with the Fifth Circuit's own pleading rules outside the PSLRA. For example, the Fifth Circuit is clear that under Rule 9(b), a defendant's intent, knowledge, and state of mind for purposes of common law fraud "may be averred generally." *Tuchman v. DSC Commc'ns Corp.*, 14 F.3d 1061, 1068 (5th Cir. 1994). Similarly, outside the securities fraud context, the Fifth Circuit has held that pleading fraud under Rule 9 requires particularity only as to the "'time, place and contents of the false representations, as well as the identity of the person making the misrepresentation and what [that person] obtained thereby.'" *Williams v. WMX Techs., Inc.*, 112 F.3d 175, 177 (5th Cir. 1997) (quoting *Tuchman*, 14 F.3d at 1068); *see also Tel-Phonic Servs., Inc. v. TBS Int'l, Inc.*, 975 F.2d 1134, 1138-39 (5th Cir. 1992) (allowing general averment of fraud for RICO predicate acts); *ABC Arbitrage Plaintiffs Group v. Tchuruk*, 291 F.3d 336, 350 (5th Cir. 2002) (under 9(b), complaint must set forth "the who, what, when, where, and how" of the events at issue) (internal quotations omitted); *Dorsey v. Portfolio Equities, Inc.*, 540 F.3d 333, 341 (5th Cir. 2008) (distinguishing common law fraud pleading require-

ments from PSLRA requirements for pleading scienter).

All of these general pleading requirements were indisputably satisfied here. In order to affirm dismissal of the common law fraud claims, therefore, the Fifth Circuit had to ignore them, as well as underlying Texas law, and instead rely on its own distinct pleading rules for fraud against corporations and officers. This squarely raises the first question presented to the Court: whether there is indeed a heightened pleading standard under the federal rules for fraud allegedly perpetrated by corporations.

There is a related reason for vacating and remanding this case to the Fifth Circuit. The Fifth Circuit did not have the benefit of the Court's opinion in *Iqbal*, in which the Court categorically ruled that the federal rules apply across the board and that federal courts are not free to pick and choose their application to preferred or dispreferred causes of action. 129 S.Ct. at 1953. The creation of a distinct pleading regime depending on the corporate character of the defendant is now squarely foreclosed by *Iqbal*.

Finally, the use of federal procedural law to defeat the Texas pleading standards for common law fraud implicates another issue, currently before the Court in *Shady Grove Orthopedics Assocs., P.A. v. Allstate Ins. Co.*, No. 08-1008.[6] The question presented in *Shady Grove* is whether a state rule prohibiting the use of class actions should be binding when a state law claim is brought in federal court. If the Court were to hold in *Shady Grove* that federal diversity jurisdiction cannot override state law procedures that

---

[6] *Shady Grove Orthopedics Assocs., P.A. v. Allstate Ins. Co.*, 549 F.3d 137 (2d Cir. 2008), *cert. granted*, 129 S.Ct. 2160 (2009).

form an integral part of the substantive law governing a particular cause of action, then the Court should vacate the common law fraud portion of the Fifth Circuit's opinion and remand for further proceedings.

CONCLUSION

For the foregoing reasons, the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

FRANCIS J. BALINT JR.
BONNETT FAIRBOURN
FRIEDMAN & BALINT PC
2901 N. Central Avenue,
Suite 1000
Phoenix, AZ 85012

DAVID W. DODGE
DAVID W. DODGE PC
Regency Plaza
3710 Rawlins, Suite 1600
Dallas, TX 75219

SAMUEL ISSACHAROFF
Counsel of Record
40 Washington Square South
New York, NY 10012
(212) 998-6580

ROSEMARY SHOCKMAN
SHOCKMAN LAW OFFICE PC
3001 E. Camelback,
Suite 120
Phoenix, AZ 85016

Counsel for Petitioners